Indian Financial Market: A quick introduction

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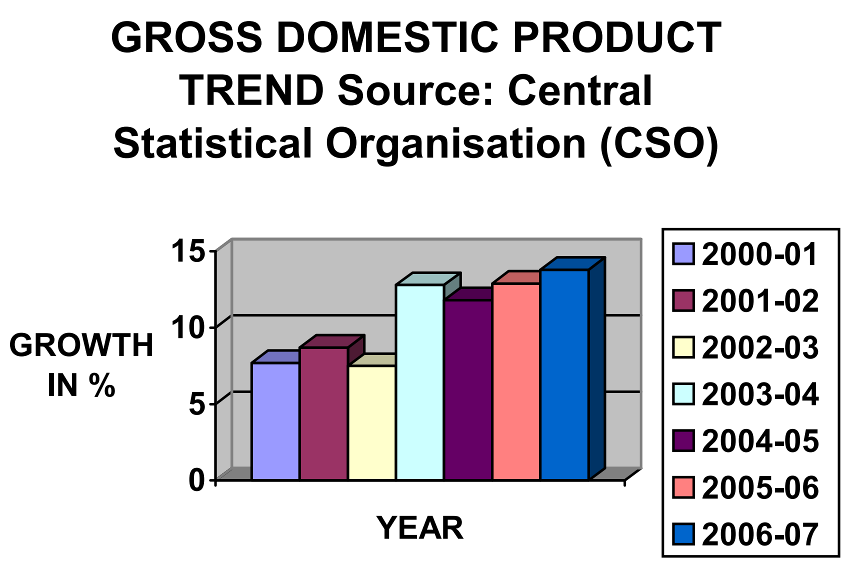
Today--with the 'FEEL GOOD' factor about India in the global arena rising, increased confidence of the investors in the Indian market, Sensex looking more attractive than ever before, foreign exchange reserves at an all-time high of more than $140 billion --is the most susceptible period for the regulators of the Indian financial sector, particularly SEBI and RBI. In spite of the strict vigilance by the regulators, the investors find Indian market very attractive.

In recent years, the Indian economy has seen a great transformation from a closed, controlled, slow growing economy to a more open, liberalised and one of the fastest growing economies of the world. Economic reforms in India since July 1991 have accelerated growth, enhanced stability and strengthened both external and financial sectors.

The rate of savings in India is constantly rising. The gross domestic savings in the year 2005-06 is estimated at 1156809. The rise in the savings rate has with an increase in the rate of growth of GDP over the last three years, suggesting that the economy is transiting to a sustainable, higher growth trajectory.



Therefore, Indian markets provide good opportunities to investors from all over world. Investments in Indian market are considered as the safest investment by the investors.

Financial Intermediaries

A structural change was noticed in the Indian financial system with the establishment of a host of financial intermediaries during the second phase of evolution of the system. Financial intermediaries comprises of public financial institutions, NBFCs, mutual funds, commercial banks, housing bank etc.

Foreign Currency Borrowings

In India,* External debt exposure to financial intermediaries is *regulated. Their foreign currency borrowings have been subject to the prudential limit of 25 per cent of their Tier-I capital. These limits amounted to US $ 2.7 billion as of March 31, 2006. With a view to enabling banks to raise resources overseas, the latest monetary policy announcement on October 31, 2006 has enhanced this limit to 50 per cent of their Tier I capital, or US $ 10 million, whichever is higher. With a move towards fuller capital account convertibility, banks are likely to access forex markets more, underscoring the need for further enhancement of the risk management capabilities of the banking system.

Banking Companies

The banking sector is the soul-life-blood of the financial system in India. Significant progress has been made with respect to the banking sector in the post liberalization period. The financial health of the commercial banks has improved manifolds with respect to capital adequacy, profitability, asset quality and risk management. Further, deregulation has opened new opportunities for banks to increase revenue by diversifying into investment banking, insurance, credit cards, depository services, mortgage, securitization, etc. Liberalization has created a more competitive environment in the banking sector. The aggregate foreign investment (FDI plus FII) limit for the private sector banking has been raised to 74 percent in the recent country budget. The competition has increased within the banking sector (with the emergence of new private banks and foreign banks) as well as from other segments of the financial sector such as mutual funds, Non Banking Finance Companies, post offices and capital markets.

Structure

The central bank of the country is the Reserve Bank of India (RBI), established in April 1935. Reserve Bank of India was nationalised in the year 1949. The banks in the Indian Banking System are broadly classified into Scheduled Banks and Non-Scheduled Banks. Nationalised Banks, State Bank, State Co-operative Banks and Regional Rural Banks come under the purview of Scheduled Banks whereas Private Sector Banks forms the Non-Scheduled Group.

Asset-wise position of Banks

The total assets of the Public sector banks in aggregate amounts to Rs.2014898.35 crore as per the last Balance Sheet. The Nationalised banks hold assets worth Rs1234462.40 crores. The Private Sector Banks hold assets worth Rs. 571407.59 crores. Foreign Banks in India hold total assets worth Rs.201585.69 crores.
(Source: Balance Sheet of respective banks)

Indian Banking structure also includes the unorganised indigenous sector, which is a mix of diverse institutions. The Reserve Bank of India is constantly making efforts to bring the unorganised sector under their regulatory framework.

Cash Reserve Ratio (CRR)

CRR is the amount of cash reserve that is required to be maintained by commercial banks in India with the RBI. The RBI hiked the CRR by 50 basis points to 5.5 per cent in two stages on 23 December 2006 and 6 January 2007. Currently the CRR is 5.75% of the net demand and time liability. From the fortnight beginning from March 3, 2007, the CRR will be 6%. (Source: RBI)

Statutory Liquidity Ratio (SLR)

SLR is an instrument in the hands of RBI to impose supplementary reserve requirements on the banking system. The maximum limit of SLR in India is 40%. It was 20% in 1963 and rose to 38.5% in 1990. The current limit is 25%. The Government has issued ordinance giving more flexibility to the RBI to fix SLR below the current stipulated limit of 25%.

Specialised financial entities – Housing finance companies

A company, which mainly carries on the business of housing finance or has as one of the main objects in its Memorandum of Association, business of providing finance for the housing. To start business of housing finance, the Housing Finance Companies has to get it registered with the National Housing Bank. The principal mandate of the Bank is to promote housing finance institutions to improve/strengthen the credit delivery network for housing finance in the country. The Bank has played a facilitator role in this regard instead of itself opening such dedicated housing finance institutions

Non- Banking Finance Companies

Non-Banking Financial Companies are under the regulatory framework of Reserve Bank of India by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934

At the end of June 2006, there were 13014 NBFCs registered with the Reserve Bank of India, including 428 NBFCs, which are accepting public deposits. During the year 2005-06, Net-owned funds of NBFCs increased by 562 crores despite a decline in the number of reporting NBFCs. Total assets/liabilities of NBFCs (excluding reporting NBFCs) at the end of March 2006 were Rs. 35561 crores, down marginally by 1.2 percent from 36003 crores at end of March 2005. in the year 2005-06, there was a significant decline in fee-based income of the NBFCs while there was a marginal increase in fund-based income.

A slight overview of NBFCs vs. Banks

- ***NBFCs have a much lighter regulation than that applicable to banks.***
- ***Formation of an NBFC is much easier than forming a bank.***
- ***Foreign direct investments in NBFCs are also much easier than those in case of banks.***
- ***A NBFC cannot accept demand deposits like banks***
- ***It is not a part of the payment and settlement system and as such cannot issue cheques to its customers***

Investment Intermediaries

Mutual funds

"Put not your trust in money, put your money in trust"- is the perfect way by which we can understand the concept of mutual funds. The small investors who lacks expertise to choose the right kind of investment for themselves opt for a kind of collective investment vehicle like Mutual Funds which pool their marginal resources, invest in a wide range of securities and distribute the returns.

The pioneer in the field of mutual fund is Unit Trust of India established in 1964. Net mobilisation of resources by mutual funds increased by more than four-fold to Rs. 104950 crores in 2006 from Rs. 25454 crore in 2005. The share of UTI and other public sector mutual funds in the total amount mobilised was around 22.5% in 2005 and 17.8% in 2006. The total assets under the management of mutual funds during at the end of 2006 was recorded at 323598 crores.

Risk transfer institutions

Our everyday life is subjected to an innumerable risk like risk of premature death, poor health, unemployment, loss due to natural calamities etc. Many of these risks are out of our control. Insurance provides us an opportunity to cover the risk at least in monetary terms.

The business of insurance is broadly classified into life insurance and non- life insurance or general insurance as discussed below:

In the beginning of the year 2000, the insurance industry mainly comprises of two players- The Life Insurance Corporation of India for effecting life insurance and The General Insurance Corporation of India with its four subsidiaries for effecting fire insurance, marine insurance and other miscellaneous insurance. From then, a number of insurance companies have emerged both in the public and private sector to cater to the needs of the society.

As all other markets, the insurance market is also highly regulated. The Insurance Act, 1938 was the first legislation governing not only life insurance but also the non-life insurance business in India. After the nationalisation of the insurance business in1956, Insurance Regulatory and Development Authority regulate the insurance business in India.

Capital Market

"Capital Market is a market for financial investments that are direct or indirect claims to capital". It comprises of the institutions and mechanisms through which funds are pooled and made available to business, government and individuals.

***With the expansion of commercial banking and unprecedented development of multinational corporations, the domestic financial markets has assumed global outlook.
The integration of world financial and capital market with that of the Indian provides greater benefits to both the demanders and suppliers of funds and opportunity to diversify risk. This globalisation has added depth to the market with a large number of market participants.***

Capital market: primary

The market wherein resources are mobilised by companies through issue of new securities is termed as the primary market. In India, the primary market has grown exponentially during the last decades.

Funds mobilisation from the market reached its peak in the year 1993-94, 1994-95 and 1997-98. During the year 2006, a total of Rs.161769 crores was mobilised through primary market by a combination of equity issue, debt issue, private placement and Euro issues (ADR/GDR).

Capital market is firmly regulated by the Securities and Exchange Board of India (SEBI) to offer better protection to the investors. The introduction of SEBI Guidelines for Disclosure and Investor Protection during 1992 revolutionised the Indian capital market. Later it was replaced by the Guidelines issued in 2000 and SEBI is frequently updating these guidelines to suit the need of the present time. SEBI has also prescribed regulations for the Intermediaries, such as the brokers, underwriters, Merchant Bankers, Mutual Funds etc.

Capital market: secondary

Secondary market popularly known as the Stock Exchange is referred to as the "Barometer of the economy". The stock exchanges are the exclusive centres for trading in equities.

The stock market is touching new heights year after year since 2003, with the BSE and NSE indices crossing 14000 and 4000, respectively in January 2007. The 3^rd^ of January witnessed the highest closing indices of 14015 at BSE and 4025 at NSE. NSE continued to occupy the third position after NASDAQ and NYSE in terms of number of transactions occurring during the calendar year 2006.

Debt

In a developing country like India, debt market plays a very crucial role. Debt Markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Almost all legal entity like Central and State Governments, Public Bodies, Statutory corporations, Banks and Institutions and Corporate Bodies issue Fixed income securities to secure money.

Current debt market has become more efficient, transparent and vibrant with significant retail participation.

Government of India (GOI) securities continued to account for the major part of activity In the secondary debt market. The gross issuance of GOI dated securities in 2006 amounted to Rs.14 000 crores as compared to Rs. 129,350 crore in 2005.

Derivatives

In India, derivatives trading take place under the provisions of the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992. The turnover recorded during the calendar year 2006 in NSE derivative market is 7046665 crores and in BSE derivative market is 4012 crores showing significant growth over the previous years.

Commodities market

Commodities Futures trading is a class of Derivatives trading, in which futures contracts derive their value from the ruling price of underlying commodities. This is a mechanism by which participants can enter into transactions for purchase and sale of commodities at a price, where the performance of delivery and payment obligation becomes due on a future date.

As compared to 59 commodities in January 2005, 94 commodities were traded in the commodities futures market as of December 2006, and these included major agricultural commodities, spices, metals, bullion, crude oil, natural gas and polymer, among others. Gold accounted for the largest share (31 per cent) of trade in terms of value, followed by silver (19 per cent), guar seed (11 per cent) and chana (10 per cent).

The growth in the commodity derivative trading witnessed in 2005-06 continued during 2006-07. Total volume of trade rose sharply from Rs. 1.29 lakh crore in 2003-04 to Rs. 27.39 lakh crore in 2006-07 (till December 2006).