the other, has become evident in giving the corporates a wider choice among alternate sources of funds. The integration between yield rates on Government papers and those of other debt market instruments is, however, currently at a formative stage on account of, inter alia, narrow investor base and lack of depth in secondary markets. While these changes are symptomatic of a greater interplay of market forces, the thrust of the Reserve Bank's policy is on elimination of the factors constraining free flow of resources among these segments and to facilitate opportunities for larger arbitrage so that pricing and allocation of resources become more efficient. These interlinkages, however, have also added another dimension to the conduct of monetary policy in view of the necessity to assess, on a continuous basis, the liquidity in the system and to adopt appropriate measures minimising volatility in financial markets.

Activity 10

What are the type of facilities offered by housing **finance** companies. What are some of ***the*** tax **benefits that** have **been given** to enhance the use of housing finance.

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1.17 SUMMARY

This units attempts to provide a general overview of the financial services markets in India. An attempt has been made to give you the current trends in the various components of the financial services markets. These components and their inter linkages have also been discussed. Some recent development like depository system for Indian. Stock Market and role of foreign institutional investor have also been discussed.

1.18 SELF-ASSESSMENT QUESTIONS

1. Comment upon the various types of financial services markets in India? What are some of the recent developments in these markets.
2. What do you understand by the term money market?
3. Who are the key players in the mutual fund market?
4. Comment upon the depository scheme for Indian Stock markets.
5. What is the role of payments and settlement systems in India?

UNIT 2 ISSUES IN MARKETING OF FINANCIAL SERVICES

Objectives

After going through the Unit you should be able to :

- Identify the emerging trends in the Indian Financial Markets.
- Discuss the developments in financial markets in relation to capital account liberalisation.
- Comment upon the tyranny of foreign funds.
- Discuss the stability of financial markets in the post reform era.

Structure

2.1 INTRODUCTION

India liberalised its capital account regulations in the early 1990s. It introduced current account convertibility in 1994 Direct foreign investments as 'well as portfolio investments by institutional investors has steadily increased. India is one of the few nations which were not affected by the Asia crisis of 1997. The step by step opening up the of capital account liberalisation in India is one important reason for this.

India's short-term debt and the reliance on volatile capital flows is increasing. With the opening up of its economy there has been a significant shift in several policies and programs of the Indian government. This shift is from earlier bureaucratic policy regime to capital flows-in the form of foreign direct investment and portfolio investment.

Various measures have been undertaken to open India's economy to foreign investment by relaxing policies. Unlike Chile and Japan, India did not follow "overnight change" approach of financial deregulation and liberalisation. In 1992, the Indian government began the integration of its financial markets with global finance capital. The permitted foreign institutional investors to enter its capital markets.

The allowed domestic companies to raise capital from abroad through the issuance of equity, Global Depository Receipts (GDRs), and other debt instruments.

In the begining, portfolio investments were strictly regulated by the regulatory bodies such as the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI). Portfolio investment is essentially short-term and extremely volatile. Initially taxes were imposed as an entry ban-ier in order to attract only geniune investors.

These tax-based restrictions coupled with other measures kept off the speculators, for some time, but, the foreign investors, over the years, found several loopholes in the system. As a result, the very purpose of such measures has been defeated. Further the Indian authorities have been removing controls and regulations. For instance, the aggregate cap on the holding of foreign institutional investors along with non-resident Indians (NRIs) and overseas corporate bodies (OCBs) on domestic company was raised from 24% to 40% in the 1998.

Foreign institutional investors can purchase and sell government securities and Treasury Bills. Forward covers in respect to fresh equity investment have been permitted. New financial instruments such as options and derivatives has been introduced in the Indian markets.

2.2 CAPITAL ACCOUNT LIBERALIZATION

Since 1997, the agenda of integrating Indian financial markets with the rest of the world has been extensively pushed by successive governments. Before the Southeast Asian Crisis, convertibility on capital account was the mantra in Indian financial markets. In 1994, India had introduced current account convertibility and achieved the VIII schedule of the IMF's Articles of Agreement.

The Indian rupee is now convertible on current account i.e. one can buy and sell foreign exchange for import, export and foreign travel. For any capital transaction, there are ceilings and controls. However, domestic residents and companies are not allowed to invest abroad without permit and cannot operate in currency, stock and gilt market abroad.

To look into Capital 'Account liberalisation, a committee headed by S.S. Tarapore was appointed to examine the related issues. The report has called for full liberalisation by the year 1999-2000, provided that preconditions are met, like

- A lower of the fiscal deficit
- A low inflation rate
- Adequate level of "owned" forex reserves
- Reduction in non-performing assets of the banking sector.

However this could be premature a date because the country has to achieve a sustainabls growth rate with the existing inflationary pressures despite mounting fiscal deficit and an unfavourable Balance of payments position.

Initially, the report received tremendous support from the foreign institutional investors, banks, trading and business houses, and international financial institutions. However, with the crisis in the Southeast Asia process was put on the back burner. Indian has slowly moved ahead with its plans of financial liberalisation. It first accepted the new WTO accord on financial services in December 1997. In a major development, the government announced the opening of the insurance sector to the domestic private sector by passing the Insurance Regulatory and Development Act.

Activity 1

Will the opening of markets and the growth in E Commerce bring a flow of funds from Venture Capitalists Abroad? From your knowledgel of the industry prepare a paragraph on what you think in the urgand.

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b) Do you foresee full convertibility for India in the near future? Why and Why not?

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2.3 INDIAN MARKETS AND THE TYRANNY OF FOREIGN FUNDS

India has only attracted about 5 per cent of the total capital flows to emerging markets. The impact of these flows on the local financial markets has been significant,

India expected that by inviting foreign institutional investors, the Indian markets would increase in maturity and depth. However the markets became shallow and volatile. There are more than 500 foreign institutional investors registered with the SEBI to operate in Indian financial markets, only a few dominate the markets.

Investment in India by the foreign investors until November 1997 was about $9 billion, just five top foreign institutional investors contributed over 40 per cent of the total investments. Most of it is going to one or two capital markets in the country and that too in a few stocks. The entry of foreign institutional investors has weakened the strength of domestic institutional investors in India. With huge amounts of financial resources the foreign institutional investors can make or mar the market Except for Unit Trust of India (UTI) or LIC or large banks no Indian institutional investor can match the resources of the foreign players,

Restrictions on the external commercial borrowings (ECBs) by the Indian companies were also further relaxed! Indian corporate houses prefer cheap foreign loans. Since the foreign borrowings were cheaper, many companies have used ECBs to repay their high cost rupee debt. The wide gap between the domestic and overseas interest rates and the depreciation of the rupee increased the repayment cost (in rupees) and caused problems for the management of the balance of payments for the country as a whole. This is what really happened in the case of Indonesia, South Korea and Thailand in 1997.

"Hot Money" Flows: Cause of Concern

The growth of "hot money" flows to forex reserves of India in the 1990s is a cause for concern. It increased substantially from 37.50 per cent in 1994 to 53.52 per cent by March 1997 and then further to 78.80 per cent by February 1998. This figure is higher as compared to that mentioned in the Tarapore committee.

Activity 2

How can one prevent money coming in **only** for speculation'? Discuss with you friends in the banking sector and **give** your **suggestions.**

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2.4 FINANCIAL CRISIS : THE LEARNING POINTS

Rapid global capital flows in the eighties and nineties has led to frequent financial crises in both the developed and developing countries. This problem is compounded by the domestic structural imbalances in the financial sector Management of these flows becomes extremely critical.

The financial crises in Europe in the early 90's, the Latin American Crisis in the mid 90's and the Southeast Asian crisis in the late 90's also affected other continents. India insulated itself from many of these international currency and financial crises as its markets were closed financial markets during that period.

Now' the developments in the world markets will increasingly affect Indian markets significantly. This has been exhibited by the volatility of the BSE in the recent months. The recent financial crises have exposed the dangers of liberalisation and emphasised the need for effective, and coordinated regulation lof financial markets by the state.

The Southeast Asian Financial crisis has shown how a sudden flight of capital can seriously impact the exchange and interest rates. This could destabilise multiple economies on account of increased economic integration.

India is more likely to accept only partial liberalisation of capital accounts in the coming years, The Indian government recently at the World Economic Forum at Davos, Switzerland and at G-15 Summit in Jamaica, both held in February 1999. India strongly advocated the need to regulate capital flows.

"We can't allow economies to be destabilised by someone pressing a finger on a computer key and moving billions in and out of markets. If we don't replace the present chaos with order, then globalisation will remain a 13-letter dirty word," said India's Finance Minister, Yashwant Sinha in Davos.

Subsequent to the South East Asian crisis the approach of the IMF on the issue of capital account liberalisation and financial deregulation has also softened. The conditionality clauses attached to the loans by the IMF required countries to liberalize their capital account in order'to enhance their attractiveness to private capital flows. In its latest report, Global Economic Prospects 1998-99, the Bank accepts the danger involved in maintaining an open capital account and recommends the use of capital controls when necessary.

In the 1990s, India's domestic financial corporate bodies have come to an understanding with the global players of finance capital. This has become very evident in recent years as a number of foreign institutional investors have carried out mergers and amalgamations with domestic institutional investors.

In the insurance sector too, domestic companies are joining hands with foreign investors. Realising that they cannot match the financial resources of foreign investors, the domestic corporate players have accepted the role of junior partner in the partnership with their foreign counterparts.

The foreign investors lobby, particularly international fund managers, and the foreign institutional investors are the consistent advocates of liberalisation of financial markets and capital-accounts. In the present global context, the investment liberalisation (along with trade liberalisation) is the main item of the economic agenda set up by the transnational capital. The opening of India's financial sector provides new business opportunities for the owners and managers of finance capital.

The issues related to financial markets are new to Indian groups. As global financial issues are much more complex, the Indian groups lack the expertise to understand and deal with them.

In recent months, a few efforts have been made to demystify the complex issues related to globalisation of finance in order to democratise the debates.

2.5 FINANCIAL MARKETS AND STABILITY : INDIA AFTER THE REFORMS

In the eighties the economic growth "relied mainly on high government expenditure especially in the infrastructural sectors." At lower rates of interest from public sector financial institutions". For nearly a decade the government had been borrowing even to meet its consumption requirements and the extent of public sector deficit was increasing.

This led to an ever-increasing interest burden leaving less and less for public investment and public services, increased taxes and/or inflation. Furthermore, the Indian economy had been widely regulated and protected from external competition by tariffs. Thus, the Indian industry became a high-cost industry where little or no. innovation took place.

The financial crisis activated a process of reforms that undertook to reform the structure of the Indian economy itself. These reforms eliminated the entire system of licenses and controls, restrictions on the entry of foreign capital. The State involvement or interference in the economy was reduced. Policies were aimed at enhancing the role of the market which would contribute to economic efficiency and lead to sustained economic growth. However, the process of reforms floundered the moment the crisis that brought such reform eased.

Consequently, these processes have been abandoned halfway;

2.6 ISSUES IN MERCHANT BANKING SERVICES

By end August, 1994, there were 501 merchant banks. SEBl registered these merchant bankers under four different categories. This included 50 commercial banks, *6* all India financial institutions – ICICI, IFCI, IDBI, IRBI, TFCI (Tourism finance corporation of India), ILFS (Infrastructure Leasing and Financial Services Ltd,, and private merchant bankers.

Foreign merchant bankers joined the Indian merchant bankers as a category they were Merrill Lynch, Morgan Stanley, Goldman Sachs, Jardine Fleming, Kleinwort Benson, 'under authorisation of SEBI. Yes, now competition is stiff between the merchant bankers due to joining of global players.

Problems of merchant bankers

Merchant bankers can undertake only issue related activities with an exception of portfolio management under SEBl guidelines. This resulted in floating Merchant-banking companies by the banks, as subsidiaries. Of course this enlarged the scope of activities,

SEBl stipulated a minimum net worth of Rs. 1 crore for authorisation of merchant bankers. Professional players with net worth less than Rs. 1 crore are just eliminated.

Enormous non co-operation of the issuing companies in timely allotment of sucurities and refund of application moneys are also another set of problems of merchant bankers. SEBI has put the responsibility on the merchant bankers. They have no other way but to seek the cooperation of the issuing companies to shoulder the responsibility.

Merchant banker have vital role to play in Indian capital markets, as supporters of entrepreneurship as also the investor community.

They can help growth of new issues markers. In 1970s, the amount of annual-average of capital issues by non governmental public sector stood at Rs. 90-crores only. The same just rose to Rs. 10001- crores in 1980s and to Rs. 12,7001- crores in 1990s. By end 1995, this crossed Rs. 40,0001- crores. The number of capital issues rose to 900 (issues) in 1993–94 period from 300 (issues) in 1990–1991. There is every hope this kind of trend will continue in future too due to globalisation effects.

1992 India opened up for foreign investors to play in the Indian capital markets and they invested in primary and secondary markets; and also this dispensation of the government of India permitted Indian companies to directly tap foreign capital through Euro issues. . By march 1994, US.$.5 billion entered into Indian capital markets from foreign markets. By end 2001 this flow isexpected to touch about US$100 billions, if investor confidence is upgraded.

NRI and foreign direct investments are expected to rise considerably due to a number of incentives being offered to them in India to bring into India hard currencies to augment

Indian economic growth. Naturally the correct servicing agency would be the Merchant bankers. This will augment even joint ventures both in India and abroad. So expert merchant-banking services will have to be available for the Indian corporate as intermediaries. So business is going to be great and well spruced up.

2.7 ETHICAL ISSUES

Establishing and maintaining credibility in the financial services market would require :

- Self-regulatory-organisations (SRO), in the context of corporate securities markets implies, peer regulation to promote ethical standards in business practices and also develop the integrity of market facilities sponsored by the SRO.
- Commitment is to mean setting as well as enforcing norms of business conduct and censure that often exceed prevailing business standards or statutory requirements.
- Willingness to support self-regulation-operations with proper funding as well as contributions of time and expertise to the governance of the very SRO and the conduct of its peer based regulatory activities.
- Creating non profit set up with the clear emphasis of the self-regulatory standards setting mission and objectives managed by a kind of corporate governance like corporate charter, rules and regulations.
- Demarcating the responsibility of SRO from those of its regulatory body; such legislation Inormally defines the process. SRO becomes registered, recognised by the regulatory bodies accordingly and meaningfully.

Under the shift towards ethical management, SEBI Regulations were passed. Let us see What they had done for controlling stock markets. There are stock brokers and sub brokers rules, 1992 to regulate stock exchange activity. If a stock broker or sub broker is not registered under this Act he cannot act as stock broker or sub broker. That 'is such person shall not buy sell deal in securities unless he holds a certificate granted by the SEBI under the regulation,

Of course provided that such person may'continue to buy sell or deal in securities if he has made an application for such registration till the disposal of such application.

Let us see the conditions for grant of certificate to stbck broker. The Board may grant a certificate to a stock brokers subject to the following conditions namely :

a) He holds the membership of any stock exchange.

b) He shall abide by the rules regulations and bye-laws of the stock exchange or such exchange of which he is a member. .

c) In case of any change in the status and constitution, the stock broker shall obtain prior permission of the Board to continue to buy sell or deal in securities in any exchange;

d) He shall pay the amount of fees for registration in the manner provided in regulation and

e) He shall take adequate steps for redressal of grievance of the investors with one month of the date of the receipt of the complaint and keep the board informed about the number of nature and other particulars of the complaints received from the investors.

Similarly, there are 'Conditions of grant of certificate to sub-broker' which are as follows.

The Board may grant a certificate to a sub-broker subject to the following conditions namely :

a) he shall pay the fees in the manner provided in the regulations.

b) He shall take adequhte steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep the Board informed about the number nature and other particulars of the complaints received.

c) In case of any change in the status and constitution the sub broker shall obtain prior permission of the Board to continue to buy sell or deal in securities in any stock exchange.

d) He is authorised in writing by a stock broker being a member of a'stock exchange for affiliating himself in buying selling or dealing in securities.

provided such stock broker is entitled to buy sell or deal in securities, the SEBI makes it obligatory and responsible for the stock brokers to maintain proper books of accounts, records etc. And it reads, 'that every stock broker shall keep and maintain the following books of accounts, records and documents' namely :

a) Register of transactions,
b) Clients ledger,
c) General ledger,
d) Journals,
e) Cash book,
f) Bank passbook,
g) Documents register should include particulars of shares and securities received and delivered,
h) Members contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other member,
i) Counter foils or duplicates of contract note's issued to clients,
j) Written consent of clients in respect of contracts entered into as principals,
k) Margin deposit bqok,
l) Registers of accounts of sub brokers,
m) An agreement with a sub broker specifying the scope of authority and responsibilities of the stock broker and such sub broker,

Every stock-broker shall intimate to the Board the place where the book of accounts records and documents are maintained.

Without prejudice to sub regulation every stock-broker 'shall after the close of each accounting period furnish to the Board if so required, as soon as possible but not later than six months from the close of said period a copy of the audited balance sheet and profit and loss account as at the end if the said accounting period.

Provided that, if it is not possible to furnish the above documents within the time specified the stock broker shall keep the Board informed of the same together with the reasons for the delay and period of time by which such documents should be furnished.

The above is just to indicate how the regulations are handling the ethical, management for the benefit of the investor.

2.8 ROLE OF SELF REGULATORY ORGANISATIONS

The main function of the SRO is to help smooth functioning, growth and development of healthy capital market, This is beneficial in the following ways:

- SRO is a membership organisation.
- Imposes ethical-norms, operational requirements on market participants to conform to legal requirements, established norms of commercial conduct. Fixing higher

standards of ethics and operational requirements subject to a consensus of membership. Causes a strong commitment to enforcement, collective recognition. Accepts changes due to market dynamics of the market place, new security products or advancement of technology.

- SRO and the management are collectively responsible to its membership. Imposes a cost effective scheme of regulation compatible with efficient market operations. Provides expertise and information useful in developing effective regulatory initiatives.
- Membership develops collective action based regulations for its members by its own in voluntary mechanism, i.e. every member willingly agrees to follow the rulesand abide by its regulations. Agree for enforcement action in response to violations if any.
- Members participate in rule making process as also in enforcement process. Reinforces the institutional commitment to self-regulation to achieve investor protection, also for integrity in the market place at a reasonable cost.
- Expertise among the members is available to develop workable regulations and responses to new problems/market conditions.

  SRO closely monitors day to day operations and practices in the market place and this enables it to detect new problems very quickly.

  It provides an effective platform in its precincts an effective vehicle for consultation with the regulatory bodies and legislative bodies on their related policy matters.

Thus credibility is ensured by self-regulatory mechanism. This helps investors or users of the services of these members more meaningful and acceptable to its customers.

2.9 SUMMARY

Thls unit highlights some of the emerging issues in the financial services market in India. We as a country are going through a liberalisation process which includes financial sector reforms as well. The impact of capital account liberalisation, the role of foreign institutional investors' hot money, and the other inputs have been discussed to enable you to understand some of the challenges in the financial markets today.

2.10 SELF-ASSESSMENT QUESTIONS

1. What are the preconditions of full capital account liberalisation prescribed by the Tarapore Report. Are these conditions fully met today?

2. What do you understand by the term "Tyranny of Foreign Funds"? How does it affect host countries.

3. What arq the lessons learnt from the East Asian Financial Crises. How would you apply these lessons in bank marketing.

4. Identify some more critical issues that face the financial markets today.

5. Comment upon the role and significance'of self-regulatory organisations in Financial Services markets,

UNIT 3 MARKETING OF FINANCIAL SERVICES : A CONCEPTUAL FRAMEWORK

Objectives

After going through the Unit you should be able to :

- Discuss the Concept of marketing as applicable to financial services marketing.
- Describe the concept of service product mix.
- Discuss various orientations as applied to marketing of financial services.
- Differentiate between products and services on the basis of service characteristics.
- Explain the implication of service characteristics for marketing of financial services.

Structure

3.1 INTRODUCTION

The first barter exchange can be looked upon as a reflection of the realisation that exchange added value for both the parties to the transaction. This indeed marked the dawn of marketing. The recognition of value addition ultimately led to the development of task specialisation, by far the first real step forward in economic development. The last century has seen 'marketing' develop from a mere practice, into a major academic discipline.

Marketing is both a concept and practice; an approach to exchange relationships, which provides the driving force for formulation of strategies every type of organisation.

Marketing in the true sense of the word, is relatively new to the financial sector. Until recently, marketing in most financial sector organisations was largely synonymous with advertising and public relations and it was not until the 1970s that marketing department were formed on any scale. (Newman 1984). Even then, the role of marketing tended to be more tactical. Strategic marketing was seen as a relatively low status activity with senior management being dominated by executives with a background in finance (Hooley and Mann, 1988). In the last decade marketing has developed as a more integrated function within financial service organisations largely as a result of rapid changes in the operating environment. Nevertheless, Morgan and Piercy (1990) suggest that marketing remains relatively young management function in the financial service sector.

3.2 MARKETING AND THE FINANCIAL SERVICES

1) Marketing is the process of determining consumer demand for a product or