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Indian Financial System- A Study of Select Issues

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Abstract: *The Indian financial sector today is significantly different from what it used to be a few decades back, in the 1970s and 1980s. The Indian financial system of the pre-reform period essentially catered to the needs of planned development in a mixed-economy framework where the Government sector had a predominant role in economic activity. Financial sector liberalisation in India has been calibrated on cautious and appropriate sequencing of reform measures and was marked by a gradual opening up of the economy. This gradual strategy seemed to have served the country well, in terms of aiding growth, avoiding crises, enhancing efficiency and imparting resilience to the system. In recent years, the Indian Ecosystem has grown towards the maturity. Factors like availability of funding, evolving technology, consolidation strategy adopted by a number of firms and burgeoning demand within the domestic market has given a rise to new beginnings in the forms of startups, angel investing, financial inclusion programs etc. This paper attempts to improve the current understanding of the field in three selected relevant issues. First, it endeavours to map out the investment activity that has been undertaken by a variety of angels, including some of the more prominent angel networks in India. Second, it tries to highlight the major step that Hon' ble Prime Minister Dr. Narendra Modi announced, "Start-up India, Stand up India" to promote Bank Financing for start-ups and offer incentives to boost entrepreneurship and job creation. Finally, financial inclusion is also considered to be a business opportunity for the formal financial institutions. It would help them in penetrating into unbanked areas and thereby attaining profit. In India, there is a significant increase in the efforts of having the optimal situation of financial inclusion. . Conclusively we can say that the Indian financial system has undergone` structural changes relating to ownership, competition and integration with global financial markets, the necessity of an ongoing restructuring of the regulatory framework and improved monitoring of the embedded risks in the financial system was also recognized. This process of financial liberalization resulted in innovations in instruments and processes, technological sophistication and increased capital flows.*

Keywords: *Indian Financial System, Angel Investing, Startups in India, Financial Inclusion, Liberalization*

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I. Introduction

A 'financial system' can be defined as broad arrangements of financial markets and institutions and services. It serves as an important role in an economy by channeling savings to productive uses and providing corporate governances. Developing countries attach great importance to sound financial system and deepening in the pursuit of their poverty reduction goal. A well organized financial system is a key towards the economic development of any country. It is the financial system which promotes the well being and standard of living of people by providing the necessary financial inputs for the production of goods and services .Thus, the term financial system is a broader term which comprises of financial institution, financial market, and financial services etc which are an integral part of the system. The Indian financial system is divided into organized and unorganized sector with RBI being the major regulator of the financial system, after the economic liberalization has undergone a sea saw change, which has resulted into new financial products and services which we are witnessing almost every day. Still, there are certain loopholes which need to be tightened up. The Indian firms and households are extremely diverse in nature and in order to cater to the needs of every section.

Financial System structures and culture evolve over decades and are path-dependent. They cannot be changed overnight, but are shaped by policies and regulations (UNEP).The evolution of financial system in India owes much to its vocational advantage providing geopolitical and commercial avenue. During its colonial days also it served as intre-port for region and indulged in trade to flourish. After Independence in 1947 various measures have been taken to boost the economic growth which has a considerable impact on the pattern of financial development. During the banking crisis in the fifties the emphasis was lead on the evolution of public financial institutions, control over privately owned banks etc. The turning points in the history of financial development were the nationalization of Reserve Bank of India in 1935 and the establishment of Banking

Regulation act in 1949. During the fifties the financial system was immature and reflected the underdeveloped nature of the industrial economy of the country. The mixed economic model had a significant bearing on the evolution of financial system and laid emphasis on industrialization it was during the eighties that this financial system emerged in India with the government having a dominant role in the economy.

India embarked on a substantial economic liberalization in 1991. Pursuant to the process of globalisation the economic and financial landscape of India is undergoing a significant transformation. In the process the economy has more diversified with the new sources of growth. In tune with these changes, we have seen the modernization of financial sector that has also increasingly more diversified to meet new requirements of the economy.

II. Objectives Of The Study

The objective of the paper is to highlight the selected major issues that have been arisen in recent years as a consequent to the development strategies. They can be shown as:

1. To understand the concept and status of Angel Investing in India.
2. To signify the role and relevance of Startup Initiative in India.
3. To evaluate the Financial Inclusion endeavors by the RBI and Government of India.

III. Research Methodology

The study is based on descriptive research design. The study covers the concepts and the present status of the key concepts through literature survey. The source of data is secondary which has been collected from published data of the banks, RBI annual reports and websites. The other sources encompass magazines, various journals, Research paper, text books, articles and relative websites have been consulted as the source of secondary information.

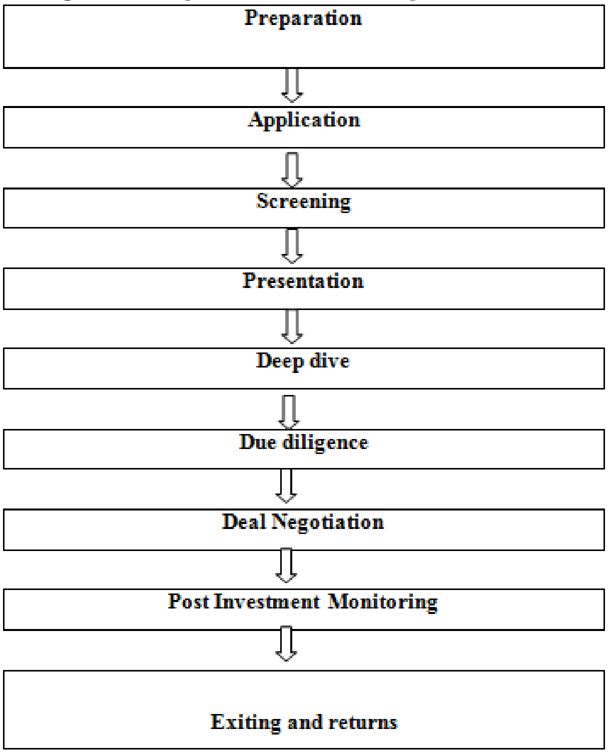
IV. New Beginnings In Indian Financial System

From its inception, the Indian capital industry has been affected by international and domestic developments. Its current situation is the result of the evolution of what initially appeared to be unrelated historical trajectories **(Dossani & Kenney, 2002).** It has been adopting the global trends in order to cope up with the pace of economic development of other countries. Many of the issues are there which originated in developed economies and later on adopted by the Indian economy which are as follows:

Angel Investing

The term angel originally comes from the **Broadway theatre**, where it was discussed for the first time to describe wealthy individuals who provided money for theatrical production that would otherwise have lead to shut down. **Shane (2009)** defines angel as "a person who provides capital, in the form of debt or equity, from his own funds to a private business owned and operated by someone else who is neither a friend nor a family". Angel investing is a very important financial innovation which is used for financing high risk, high potential seed stage venture. For an individual such investment on the venture is less than Rs 5crore and for a group in aggregate is less than 10crore. Angel investing began India in 2006. Angel investors can be defined as an individual who has made investment in the following sectors: Consumers/services, Healthcare/ Life science, Food - QSR, Analytics, Telecom / Mobile/ VAS, Education, E commerce, online services and IT/ ITES. In 2015 the new investments by angel investors has gone up to 74%. Angel investors have clubbed investment with institutional investors across for 440 deals worth $1.26 billion of which in 2015 the investments were about 702.5 million. The role of angel investment in India has been immense in terms of innovation and investment leading to the development of entrepreneurship skills and economy.

Figure 1: Angel Investment Management Process



Source: *Van Osnabrugge and Robinson (2000)*

Angel Networks

The angel investment process generally takes place through its various networks which began to put down their roots seven years ago, but it was only last two or three years that start up ventures backed by them, have began to scale and cause a dip globally. There are large no of angel networks in India but the ones which are prominent are as follows:

TABLE 1: Comparison of the four Angel networks in India

Attribute	**Mumbai Angels**	**Indian Angel Network**	**Chennai Angels**	**Hyderabad Angels**
Commencement year	2006	2006	2007	2010
Members	200+	388	72 individuals 11 institution members	65
Stage of Investment	Seed and Early Stage ventures	Start up or Early Stage.	Early Stage Investment	Startup and Early Stage
No. of portfolio companies	69	60	26	13
Deal Size	Rs 50 lakhs to Rs 2 crore	USD 400K TO 600K with a maximum of USD 1mn	Rs 50lakhs – Rs 300 lakhs	Rs 25 Lakhs to 2 crore
No of exits	14	13	4	1
Sectors of interest	IT products and services BPO/ knowledge process	All sectors- " Preference for " telecom, mobile	E- Commerce, Education and IT.	Sector Agnostic.

Source*: G.Sabrinathan (2014)*

The table1 shows the comparison of different angel networks operating in India. The Indian angel network has maximum number of members with Mumbai angels which was once leading is on the second spot the reason behind this the overall sectors which Indian Angel network has covered is maximum and the exit opportunities are also high while the Hyderabad angels need to work towards providing various opportunities to the members so that they want to invest through it.

Angel Investing Promoted By Central Government:

- The government has started to contribute as an Angel investor to help SMEs through its **"Credit Guarantee Fund Trust for SME** "which allows banks to grant loans up to the sum of Rs 1 crore to small enterprises without any collateral security.

- In 2013 Budget, Government proposed to recognize Angel Investors to be registered under SEBI **AIF Category I** which has tax pass through status. This removes ambiguity, avoids double taxation and offers some relief to this industry.
- Government also provided liquidity for early stage investments in SME / start- ups and will also give Angel / VC investors an additional exit route.

Start-Ups

According to Cheung, " Start up is a state of mind". Start up means "the act or an instance of setting in operation or motion or a fledging business enterprise". A start up is a company designed to scale very quickly. It stops being a start up when people don't feel as though what they are doing has no impact". Early stage in the life cycle of an enterprise where the entrepreneur moves from the idea stage to securing financing, laying down the basic structure of the business, and initiating operation or trading. A start up is a young company i.e. beginning to grow and develop is financed by an individual or group of individual during the first stages of production **(Thornton, 2015)**.

Currently a clear definition of a startup does not exist in the Indian context due to the subjectivity and complexity involved **(Thornton, 2015)**. According to the government of India an entity will be defined as a start up:

- Till up to five years from the date of incorporation.
- If its turnover does not exceed 25crores in the last five financial years.
- It is working towards innovation, development, deployment, and commercialization of new products, process or services driven by technology or intellectual property.

According to Infosys cofounder a Start up is defined as a business within the first three years of its existence. It should employ 50 people or less. It should generate revenue of INR 5crore or less.

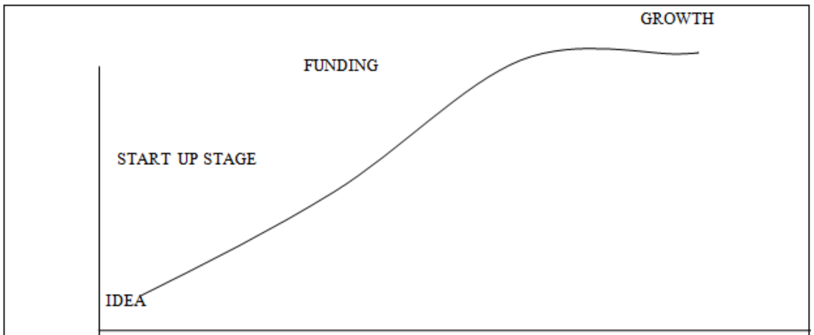
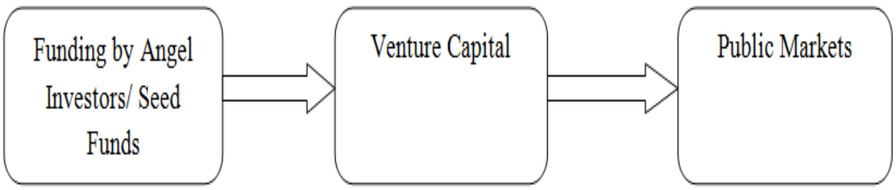


Figure 2: Stages of Startup

Source: Startup profession

Funding Of Startups in India:

Figure 3: Startup financing life cycle



Source: Startup ASSOCHAM Report 2015, Grant Thorntan

In the earliest stage, startups rely on angel investors and seed funding. Investment is made solely into the entrepreneur with an idea. Later on, venture capital is used to scale the company' s model. Venture capital funds come from larger institutional funds and the focus is on building the sales force and establishing a global presence. In the late stage startups can feel the need to expand to expand more aggressively or actively innovate the product. Private equity funds together with public markets provide large amounts of liquidity to late stages of the startups

Indian Startup Ecosystem

Figure 4: Indian startup industry composition

SECTOR CONCENTRATION **No. of Startups at present (Approx): 10,000** **No. of Startups Annually (Approx): 800**	
TECHNOLOGY BASED STARTUPs	**NON-TECHNOLOGY BASED STARTUPSs**
No. of Startups: 4300 (43%)	No. of Startups: 5700 (57%)
E-commerce- 33%	Engineering- 17%
B2B- 24%	Construction -13%
Mobile Apps-10%	Textile- 8%
Customer Internet-12%	Agricultural products- 11%
SAAs-10%	Printing & Packaging- 8%
Others- 13%	Outsourcing & Support- 5%
	Other- 32%

Source: Nassocom 2015 startup India report, Grant Thornton

Current Status OF Indian Startup:

India has transformed itself into a startup nation. It is the third largest startup in the world .The average age of startup founder is 28 years .9% of total startup founders are women. The average number of new technology startup has moved from 480 in 2010 to 800 in 2015. It is expected to increase to 2000 in 2020. The number of incubator has grown by 40% to 110 during 2014-2015. There is approximately 50% growth in share of female entrepreneur in last 12 months. 43% of total startups are technology based. Majority of startup are from metro cities with leading in no of startups. 60% of approximate new jobs were created by SMEs during 1993- 2013. The number of PE /VC firms has doubled in the last 12 months.

Initiatives Towards Startups

The numbers of initiatives taken by government towards Startups are:

- **Make in India:** This big initiative was launched by PM Narendra Modi on September 2014 to draw the attention of the companies towards making investment in the manufacturing sector. The whole campaign is directed towards attracting foreign investment and domestic companies to boost the manufacturing sector .The government has created a conducive environment by increasing the FDI limits for most of the sectors and providing protection against the intellectual property rights of innovators.
- **Standup India:** In 2015 a new campaign was announced for encouraging young entrepreneurs by providing bank funding to help startups. The focus is towards promoting entrepreneurship among the women, scheduled caste and scheduled tribes by providing the necessary funding required. On 6th January, 2016 the cabinet has given approval to the campaign.
- **Digital India:** The initiative commenced in July 2015 is concerned with making government services available through online platform .It has paved the way, for E- commerce companies in India to enter the Indian rural market as part of the initiative.
- **Micro Units Development Refinance Agency (MUDRA) Scheme:** The scheme was launched in 2015 for boosting the growth of small business and manufacturing units.
- **India Aspiration Fund:** The scheme is focused towards encouraging start up ecosystem and for allocating INR 400 cr. to various funds. The program SMILE has also been launched which is directed towards providing soft loans in the form of quasi- equity and term loans on soft terms to MSMEs.
- SEBI has announced a new set of norms for startups consisting of e-commerce that are planning to raise funds from listing on stock exchange.

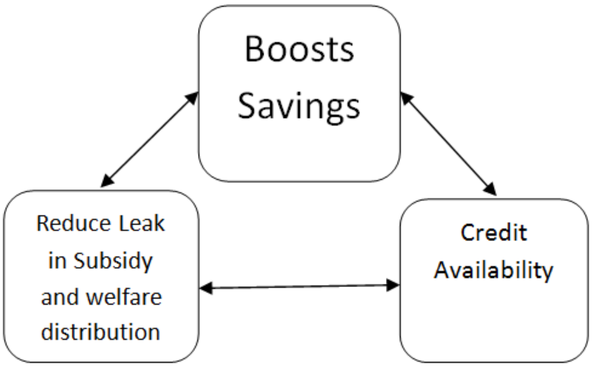
Financial Inclusion

The process of ensuring access to appropriate financial products and services needed by all sections of society at affordable cost in a transparent manner by mainstream institutional played is termed as financial inclusion **Chakraboroty (2011).** The committee on financial inclusion, Government of India defined financial inclusion as the process of ensuring timely access to financial services and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost **(Rangarajan committee, 2008).** Financial inclusion refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products **(Planning Commission, 2009)**. **Hanning and Jansen (2010)** has the idea that financial inclusion aims at drawing the "unbanked" population into the formal financial system so that they have the opportunity to access financial services ranging from savings, payments, and transfers to credit and insurance. However, World Bank has defined financial inclusion as the proportion of individuals and firms that use financial services and has the view that financial inclusion and access to finance are different issues. The lack of use does not necessarily mean a lack of access.

Financial Inclusion In India And Its Significance

Even after 65 years of independence, a large section of Indian population still remains unbanked. The malaise has lead to generation of financial instability and pauperism among the lower income group who have no access to financial products and services. Global trends have shown that in order to achieve inclusive development and growth, the expansion of financial services to all section of society is of utmost importance. The financial inclusion provides various benefits like it reduces inequality, poverty alleviation, sustainable development, step towards inclusive growth etc.

Figure 5: Benefits of financial inclusion



Source: *RBI Annual Report*

Role Of Banking Sector Towards Financial Inclusion

Banking sector has been one of the most integral parts of financial inclusion. In the recent years the efforts towards financial inclusion has been accelerated. It is not a new concept earlier a lot of efforts have been put towards financial inclusion like nationalization of banks, building up of robust network of scheduled commercial banks, cooperatives and regional rural banks, introduction of mandatory sector lending targets, lead bank scheme, formation of self help groups . The fundamental objectives of all these initiatives were to reach the large sections of the financially excluded Indian population **(Shaik, 2015)**. RBI in 2004 through Khan commission went through the extent of the financial exclusion, in 2005-2006 committee report extorted various measure over the deepening problem of financial inclusion since then the RBI has followed a bank lead approach towards financial inclusion and provided a conducive regulatory environment for the smooth flow of various measures towards financial inclusion. RBI has always emphasized upon the deepening and widening reach of financial services so as to cover a large segment of the rural and poor sections of population (Financial inclusion summit, 2016).

Initiatives Of RBI Towards Financial Inclusion

RBI being the regulatory body of the banking sector has taken various measures to provide financial services to the unbanked population which are as follows:

- Opening of no frill account
- Simplified KYC norms
- Business correspondent model
- Use of ICT in providing services
- General Card credit and Kisan card credit
- Financial literacy: It is a key component of financial inclusion. It is focused towards providing financial education so that individuals can identify and use appropriate financial products and services in, order to build and preserve their assets overtime. The RBIs financial literacy efforts are channeled through banks in the form of a mass scale literacy campaign which includes conducting financial literacy camps in unbanked locations **(Haseena Shaik, 2015).**
- Priority sector lending: It is one of the major initiatives to provide affordable credit to the weaker sections of the society which includes agriculture, artisan ,textiles etc .Various payment banks and small finance banks have been set up to provide easy credit to the priority sector which have been neglected till now.
- Financial inclusion plan.

Initiatives Taken By Government Towards Financial Inclusion

The government has taken major initiatives towards making financial inclusion a national objective which are as follows:

- **Pradhan Mantri Jan Dhan Yojna:** PMJDY is a national mission for financial inclusion launched by PM Narendra Modi on 28th Aug, 2014 encompassing an integrated approach towards bringing out comprehensive financial inclusion to all the households in the country.(Anjana Bedi , 2015). It provides access to financial services, namely banking / saving & deposits accounts, remittance , credit , insurance, pension in an affordable manner.(Anoop Kumar Singh, Ankita 2015).
- **Aadhar-Unique identification Authority of India (UIDAI)**: It was created through a notification issued by the government in 2009. It is an initiative to provide an individual identification number to every citizen of India which will serve as proof of identity and address, anywhere in India and enable people to have access to services such as banking , mobile phone connections and other government and non government schemes.
- Immediate Payment System launched by National Payment Corporation of bank
- RuPay cards launched by NPCI are a new card payment scheme at a lower cost.
- ADHAR enabled payment system is now a banking product allowing on line inter operable financial inclusion transaction at the micro ATM or, kiosk banking business correspondent.
- Micro Units Development Refinance Agency (MUDRA) Bank: It is a recent development in the land of financial inclusion. It will be primarily responsible for laying down guidelines for micro enterprise financing business.

Financial Inclusion Progres

Table 2: Financial Inclusion Progress Report

Progress under Financial Inclusion Plans, All SCBs including RRBs						
Sr. No.	**Variable**	**Year ended on March 2013**	**Year ended on March 2014**	**Year ended on March 2015**	**Year ended on March 2016**	**Year ended on March 2017**
1	Banking Outlets in Villages - Branches	40,837	46,126	49,571	51,830	50,860
2	Banking Outlets in Villages – Branchless Mode	2,27,617	3,37,678	5,04,142	5,34,477	547,233
3	Banking Outlets in Villages – Total	**2,68,454**	**3,83,804**	**5,53,713**	**586,307**	**598,093**
4	Urban Locations covered through BCs	27,143	60,730	96,847	102,552	102,865
5	Basic Savings Bank Deposit Account (BSBDA) through branches (No. in million)	101	126	210	238	254
6	Basic Savings Bank Deposit Account (BSBDA) through branches (Amt. in Rs. billion)	165	273	365	474	691
7	Basic Savings Bank Deposit Account (BSBDA) through BCs (No. in million)	81	117	188	231	280
8	Basic Savings Bank Deposit Account (BSBDA) through BCs (Amt. in Rs. billion)	18	39	75	164	285
9	BSBDA Total (in million)	**182**	**243**	**398**	**469**	**533**
10	BSBDA Total (Amt. in Rs. billion)	**183**	**312**	**439**	**638**	**977**
11	OD facility availed in Basic Savings Bank Deposit Account (No. in million)	4	6	8	9	9
12	OD facility availed in Basic Savings Bank Deposit Account (Amt. in Rs. billion)	2	16	20	29	17
13	Kisan Credit Cards-Total (No. in million)	34	40	43	47	46
14	Kisan Credit Cards-Total (Amt. in Rs. billion)	2,623	3,685	4,382	5,131	5,805
15	General Credit Card-Total (No. in million)	3.63	7.4	9.2	11	13
16	General Credit Card-Total (Amt. in Rs. billion)	76.34	1,097	1,302	1,493	2,117
Note: Absolute change could be slightly different as numbers have been rounded off to million/billion.						

Source: RBI Annual Reports

Creating the architecture of financial inclusion is of course necessary. But financial inclusion would ultimately occur only when more and more people are able to get gainful employment in the economy; only that would ensure that moneys begin to flow into the Bank accounts and people are able to confidently pay the necessary insurance premiums and pension subscriptions. There is widespread hope that the Government and RBI would indeed take steps to ensure the maximum level of Financial Capability and create such employment opportunities for large numbers. The Government must also begin creating the physical architecture to deliver nutrition, education and health. The efficiency, speed, commitment and confidence with which the Government has moved towards creating the structure of financial inclusion gives hope that soon equally effective steps would be taken to create the physical structures necessary for delivering nutrition, education, health and old-age care for all. Ultimately, that is what makes a society inclusive and empowered.

V. Summary & Conclusion

The economic development of a nation relies on a well organised financial system. It is the financial system which leads to productive channelization of funds by acting as an intermediary between the savers and investors and promoting economic growth. In the recent years the government of India has created a wide spectrum of oppurtunities and new programmes for nurturing innovation across a number of sectors. The small and big entrepreneurs, industry, investors and undeserved sections of the society are the prime focus of the government initiatives. The new beginnings in the financial system such as start-ups, financial inclusion and angel investing is a clear indication of the transformation in the India financial system . Digitization has played an integral part in changing the financial structure of the country. Start-up a dream of millions has come into reality after getting a backing of the government. India is now considered a preferred destination for investors over other major countries which is a result of its huge market base and favourable business environment. Angel investing has also turned out to be boon for various individual who needed funding to back their ideas whereas financial inclusion with the help of technology is trying to make the unbanked section of the society a part of the financial system. Hence, it can be concluded that financial liberalization has resulted in innovations in instruments and processes, technological sophistication and increased capital flows which has enabled India to compete with other economies of the world.

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