



THE EMERGING ROLE OF FINANCIAL SERVICE SECTOR FOR SUSTAINABLE ECONOMIC DEVELOPMENT AND GROWTH

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ABSTRACT

Finance holds the key to achieving long-term growth prospective for any country. As the economy grows and becomes more complex and market-oriented, the financial sector starts playing a crucial role in supporting growth by channeling domestic and foreign capital into productive investments. Increasing access to the financial system is also a main concern for making growth more balanced and sustainable, from both economic and social perspectives. Financial services are fundamental to economic growth and development. Banking, savings and investments, insurance, debt and equity financing help private citizens save money, guard against uncertainty, and build credit, while enabling businesses to start up, expand, increase efficiency, and compete in local and international markets. For the poor, these services reduce vulnerability and enable people to manage the assets available to them in ways that generate income and options-ultimately creating paths out of poverty. In current picture, all over the world, there is an increasing understanding about Corporate Social Responsibility (CSR), Sustainable Development (SD) and Non-Financial Reporting (NFR). Accordingly, there is an effort being made among all types of organizations to ensure that sustainable development is not lost sight of, in the pursuit of their respective goals - profit making, social service, humanity, etc. The contribution of financial institutions to sustainable development is paramount. The Central Bank i.e. Reserve Bank of India feels that there is lack of awareness in India about this concept so in this context they felt the need for sustainable developmental and efforts by financial institutions in India assumes urgency and banks, in particular, can help contribute to this effort by playing an important role. RBI in its notification has advised banks to take up this issue in a serious manner in order to make an appropriate move towards helping the cause of Sustainable development. Banks are now-a-days doing their best in promoting sustainable development. They have taken up the challenge to be socially responsible by way of linking up with SHG's for the welfare of weaker sections, providing no frill accounts etc. This paper emphasizes the concept of sustainability in India and analyses the Sustainable development initiatives taken up by the Indian financial sector. It also focuses on the emerging role of financial service sector for sustainable economic growth and development.

KEYWORDS: Sustainability, CSR, Non-Financial Reporting, Financial Service, Indian Financial Sector.

INTRODUCTION

The financial services sector describes a significant share of economic activity in most countries. The sector is acknowledged for its involvement in long-term growth and efficiency in channeling resources to all sectors of the economy. Improved provision of financial services enables greater efficiency in other sectors by expanding the range and enhancing the quality of such services, by lowering costs of funds, and by encouraging savings and more efficient use of these savings. India has a diversified financial sector, which is undergoing rapid expansion. The sector consists of commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. India's services sector has always served the country's economy well, accounting for about 57 per cent of the gross domestic product. In this regard, the financial services sector has been an important contributor. The Government of India has

introduced reforms to liberalize, regulate and enhance this industry. At present, India is definitely one of the world's most vibrant capital markets. Financial services are fundamental to the functioning of an economy. Without them, individuals with money to save might have trouble finding those who need to borrow, and vice versa. And without financial services, people would be so intent on saving to cover risk that they might not buy very many goods and services. Moreover, even relatively simple financial goods can be complex, and there are often long lags between the purchase of a service and the date the provider has to deliver the service. The market for services depends a great deal on trust. Customers (both savers and borrowers) must have confidence in the advice and information they are receiving. The importance of financial services to the economy and the need to foster trust among providers and consumers are among the reasons governments oversee the provision of many financial

services. This oversight involves licensing, regulation, and supervision, which vary by country.

Productive uses

Financial services help put money to productive use. Instead of stashing money under their mattresses, consumers can give their savings to intermediaries who might invest them in the next great technology or allow someone to buy a house. The mechanisms that intermediate these flows can be complicated, and most countries rely on regulation to protect borrowers and lenders and help preserve the trust that underpins all financial services.

The financial services sector has undergone important structural changes in recent years with growing numbers of worldwide cross border mergers and acquisitions and increased competition among different types of financial institutions. These structural trends are evident from rising cross border trade and foreign investment flows in financial services, with the developed countries being the main exporters of such services. As a result, the financial services sector has become an important part of the overall globalization of the service sector. This has ensured that the new emerging face of the Indian financial sector will culminate in a strong, transparent and resilient system.

LITERATURE REVIEW

Economists believe that the most important role of the financial sector in facilitating growth is to reduce information, enforcement, and transaction costs. This is achieved through a number of specific functions that the financial sector performs. On the basis of an extensive survey of the literature, Levine (2004) identified and summarizes these as follows: (i) countries with better-functioning banks and financial markets grow faster; (ii) simultaneity bias (i.e., the reverse causality) does not seem to drive this conclusion; and (iii) better-functioning financial systems ease the external financing constraints that impede firm and industrial expansion, suggesting that this is one mechanism through which financial development matters for growth. Nobel Laureate Robert Lucas (1988) also dismisses finance as an over-stressed determinant of economic growth. On the other hand, Nobel Laureate Merton Miller (1988) argues that the financial markets contribute to economic growth is a proposition too obvious for serious discussions.

Schoar (2009), while agreeing that a competitive banking sector plays an important role in facilitating firm growth and competition, and that (public) equity markets can at best constitute a small fraction of overall financing in developing countries, questions promoting small banks as a solution.

Zingales (2009) agrees that what works for a developed country does not necessarily work for a developing one and that in most developing countries today; the goal of financial sector development should not be to push for an immediate development of stock markets.

Thoma (2009) agrees that developing countries need small banks and microfinance to meet many of basic financial needs, but also need more sophisticated financial products and services, such as hedging price risks through futures markets, insuring against crop failures, purchasing farm equipment

through pooling arrangements, and managing the problem brought about by seasonality.

OBJECTIVES OF THE STUDY

The main objectives of the study are as follows:

- To know the role of financial service sector for sustainable economic growth and development.
- To study the initiatives taken for expansion of financial services sector in developing countries.

India's services sector has been the most dynamic part of its economy, leading GDP growth for past two decades. India is doing reasonably well in retail sector and the financial sector including insurance. India is now eager to open up the pensions sector also to foreign investors. The way these sectors have been developed with a strong regulatory and policy framework also holds important lessons for other countries. India's financial services sector has been one of the fastest growing sectors in the economy. The economy has witnessed increased private sector activity including an explosion of foreign banks, insurance companies, mutual funds, and venture capital and investment institutions. Although significant steps have been taken in reforming the financial sector, some areas require greater focus.

- The ability of the financial services sector in its present structure to make available investible resources to the potential investors in coming years, such as equity and long term, medium and short-term debt.
- The inability of banks to quickly enforce security and access to collateral, and the capital constraints in recognizing large loan losses.
- Volatility in global commodity prices has had a major impact on Indian companies. This has led to non-performing loans and provisioning for credit losses becoming a key area of concern for the Indian financial system.

WHAT SHOULD FINANCIAL SECTOR DO TO PROSPER IN STRATEGIC ENVIRONMENT?

Unification

The current trend worldwide and the present debate within the country, suggests that the end of stratification between sectors and consolidation within sub-sectors would be inevitable. For example the financial services sector may be broadly categorized into following sub-sectors: commercial banking, investment banking, development banking, asset management, securities trading and distribution, insurance and NBFCs. Unification in the shape of cross-over between banking and insurance and the emergence of bancassurance is a case in point.

Customer Centric Approach

Indian customer are becoming more discerning and demanding as the global practices are getting more exposure. There has been a clear shift towards those entities that are able

to offer products and services in the most innovative and cost efficient manner. The financial services sector will need to adopt a better customer-centric business focus. It will also have to create value for its shareholders as well as its customers, competing for the capital necessary to fund growth as well as for customer market share.

Engage in multi-pronged strategies for expanding economic opportunity

The primary focus of a firm should be to develop inclusive business models that make those services widely accessible. Constraints in the system however mean that inclusive business models often require complementary strategies to be viable. For example plans to offer financial transactions via mobile phone may require active engagement with governments across countries to align the incentives and policies of financial and telecommunications regulators. There is particularly significant opportunity for commercial banks to play leadership roles in institutional capacity-building, applying their expertise to strengthen entire systems.

Increase Penetration

Financial services in India still remain largely under-penetrated and there lies the opportunity for high growth. Foreign banks are likely to be allowed to acquire local banks when the next stage of banking reforms is proposed and increased FDI limit in insurance will offer good opportunities in the insurance sector. Low penetration in the pension market makes it a lucrative business segment. India also offers a once in a lifetime opportunity for PE funds to invest in the infrastructure asset class across the board ranging from core sectors such as power, roads, transport to social asset classes such as healthcare, education, environment. Other service economy infrastructure sectors like telecom, ISPs, financial payment gateways also offer massive opportunities.

Collaboration

In the financial services sector, engagement with microfinance institutions, international financial institutions, and multilateral and bilateral donors is common, particularly around microfinance. Large commercial banks have the potential to serve as lynchpins in the dynamic transformation of financial markets to offer expanding economic opportunity to the poor. While individual firms must naturally choose the strategies most appropriate for them, strong collaboration capabilities will almost certainly be essential – both within the financial sector and beyond.

Anticipate best practices in Regulation

The changes in the financial services landscape have taken place against a wider systemic backdrop of easing of controls on interest rates and their realignment with market rates, gradual reduction in resource pre-emption by the government, relaxation of stipulations on concessional lending and removal of access to concessional resources for financial institutions. The financial regulatory system in India today is far more conscious and better equipped, institutionally and legally, to demand and enforce necessary disclosures and compliance with laid norms for protection of the users of the system as well as the credibility and efficacy of the system itself. As the financial services sector players of the future will emerge larger in size, technologically better equipped and

stronger in capital base, one can only hope that the regulatory as well as the self-regulatory mechanisms will match up to the best worldwide thereby ensuring that the health of the Indian financial system is not only preserved but improved upon and its ability to withstand shocks, which are inevitable with global integration, remains strong.

MAINSTREAMING SUSTAINABILITY IN INDIAN BUSINESS

Sustainability is something which begins by being profitable and extends to the creation of value in social and environmental spheres for stakeholders and economic wealth. An effective tool for capturing the non-financial performance of a company is its sustainability report. This documents the institution's sustainability efforts and includes disclosures of its performance across economic, environmental, social and governance parameters. There is an immediate need to address environmental and social management in the financial and banking sector. It is imperative that sustainability be adopted in all streams of the institution's activities. The critical role that business enterprises will have to play in implementing the sustainable development agenda are discussed further. Some important elements of this dual role include:

Economic growth

Stronger private sector engagement in the regional economy can harness opportunities for export-oriented production, and greater participation in global and regional value chains can create and expand economic opportunities. In India, the Government is promoting 'Make-in-India' to strengthen productive capacities and drive India's growth. Business enterprises have a key in this effort.

Employment creation

Sufficient numbers of decent jobs, especially for women and youth, assist in lifting people out of poverty. In this context, the Government of India is giving priority to the 'Skill India' programme and its creation of a new Ministry of Skills Development and Entrepreneurship. Business enterprises have a clear and important role to play in the programme and in generating decent work opportunities.

Low carbon development paths

Future business models have to generate surpluses within the paradigms of sustainable development. The cost of compliance with environmental standards has to be borne, and businesses have to chart a course of low carbon growth. The need to go beyond business-as-usual models requires more creative use of technologies, and these practices can be incentivized. A good example is paper recycling in India. 'Wealth from waste' has already caught the imagination of entrepreneurs leading to several successful 'low-cost high-value' business models that use industrial residues and municipal wastes as inputs.

Sustainable Urbanization

Urban agglomeration is irreversible, and with it skyrocketing demand for urban infrastructure and services. This offers immense commercial opportunities and can be made to support sustainable development as well. By 2050 Indian

cities are expected to house more than 50 per cent of the population, which is why India's 100 Smart Cities proposal is so interesting and timely. These new cities will be developed on the basis of public-private partnerships, with a role for business in evolving more sustainable patterns of urbanization.

Green Banking and Financial Services

Financial institutions should prioritize sustainable development in their lending. In this regard the very impressive Indian Government programme on financial inclusion, "Jan Dhan", under which 115 million people now have bank accounts, is worth replicating.

Frugal innovations

Indian companies are known the world over for their frugal engineering capabilities that have led them to the development of useful but affordable products including generic medicines, the world's cheapest car, water purifiers and many other products. Frugal innovation stands for generating more business and social value while optimizing available resources.

Corporate Social Responsibility (CSR)

There is no doubt that CSR will remain an important aspect of the contribution of business enterprises to achieving the sustainable development and growth. But CSR should not be seen as a pay-off to continue unsustainable business practices. The primary delivery of sustainable development outputs must be through business practices themselves. With the new Indian law requiring 2% of profits to be earmarked for CSR this will be most effective by channeled these resources into sustainable development priorities.

PRACTICE OF SUSTAINABILITY IN FINANCIAL SERVICE SECTOR

For institutions in India's financial and banking sector, one of the primary drivers of their involvement in activities in social and environmental spheres is their reputation and branding. This is fueled by the fact that these institutions have high visibility in every business sector and industry. Moreover, in emerging markets such as India's, financing projects that focus on clean production, good corporate governance and sustainable energy are being increasingly identified as potential business opportunities for financial institutions. The RBI, in its publication Policy Environment acknowledges the term "green banking" and outlines the implementation of green IT in all the areas of its work.

Furthermore, many financial institutions are also actively publicizing their philanthropic activities under the corporate social responsibility banner. All these initiatives point to the sector's move toward financial institutions banking on their brand and reputation, to make a difference in the community in which they operate and in their new risk management strategies that reflect the socio-environmental aspects of their investments. With all these advantages linked to provision of visibility of sustainability initiatives and performance, communicating them to the concerned stakeholders is the key factor for reaping the benefits of this measure.

THE PRACTICE OF SUSTAINABILITY — GLOBAL AND INDIAN SCENARIO

Some multinational banks and financial institutions incorporate sustainability in their functions by supporting clean technologies and embedding the concept in their core business processes — risk management and decision making. They also implement environmental conservation and betterment of community initiatives within their operations. Most often, a separate foundation or organization is instituted in India under the broad corporate structure of an entity, which is then entrusted with this responsibility.

The kinds of activities these foundations support relate to education and health initiatives for underprivileged groups, partnering with and supporting a social cause agent such as an NGO or a charity; having employee engagement drives, in which employees donate a portion of their incomes, volunteer their time and share their knowledge for various community improvement causes.

Sustainability reporting

Sustainability reports underscore the commitment made by an institution to sustainability, which helps to attract investments from new avenues such as socially responsible investors, who only invest in projects that are conscious of the environments and the hazards it faces. Reporting would also showcase a financial institution's adherence to voluntary global standards. Furthermore, disclosure of sustainability performance can help in ranking institutions, based on global indices such as the Dow Jones Sustainability Index, which tracks sustainability-driven companies worldwide on their financial performance.

Currently, there are no regulations that mandate sustainability reporting. However, steps are being initiated to set up standards that will enable India Inc. to become socially and environmentally responsible. A parliamentary panel has sought a policy, which makes it mandatory for banks, major PSUs and companies in the public and private sectors to invest 50% of their Corporate Social Responsibility funds in forestation initiatives.

The Institute of Chartered Accountants of India, Accounting Research Foundation (ICAI ARF) Committee is working on a new set of rules on CSR and the Confederation of Indian Industry (CII) is developing a green rating system for Indian companies. The pressure to adopt sustainability has further intensified with the launch of Sustainable Development Funds and Indices in India such as CRISIL, S&P ESG Index.

Sustainability solutions

Financial institutions would benefit by developing a sustainability management and reporting framework, which covers, but is not limited to, identification of material issues and risks, conducting stakeholder engagements as well as environment, health safety and social audits, mapping the carbon footprint of a company's operations and developing sustainability reports. Steps that a financial services organization can take towards sustainability reporting are

- Develop a sustainability strategy
- Identify a sustainability reporting roadmap

- Develop and implement sustainability management systems
- Assess sustainability relating to risks and opportunities
- Obtain assurance on sustainability reports including on health and safety aspects

Banks and financial institutions should also consider adding further credibility to their sustainability reports through independent third-party assurance for data as well as statements and claims in these. So far, only one multinational bank has produced an independently assured India-specific sustainability report.

Investments/Developments

- India has moved a step closer to having a Singapore- or Dubai-like financial hub, with the Securities and Exchange Board of India approving a framework for international financial centres.
- The RBI has allowed bonds issued by multilateral financial institutions like World Bank Group, the Asian Development Bank and the African Development Bank in India as eligible securities for interbank borrowing. The move will further develop the corporate bonds market, RBI said in a notification.
- Maharashtra's plans to promote Mumbai as a global financial centre have received further encouragement as Wall Street firm JPMorgan Chase & Co. and the Japanese government arm Japan External Trade Organization agreed to partner with the state government to hold road shows to attract financial services companies to Mumbai.
- Yes Bank Ltd has signed a memorandum of understanding with the US government's development finance institution Overseas Private Investment Corporation to explore US\$ 220 million of financing to lend to micro, small and medium enterprises (MSMEs) in India, the bank said in a press release.
- Bandhan Financial Services Pvt. Ltd has raised Rs 1,600 crore (US\$ 252.97 million) from two international institutional investors to help convert its microfinance business into a full service bank.
- JP Morgan Asset Management (UK) Ltd, JP Morgan Investment Management Inc and JP Morgan Chase Bank NA, have acquired a 4.11 per cent stake in Mahindra & Mahindra Financial Services Ltd for Rs 113.75 crore (US\$ 17.98 million).

Government Initiatives

Several measures have been outlined in the Union Budget 2014-15 that aim at reviving and accelerating investment which, inter alia, include fiscal consolidation with emphasis

on expenditure reforms and continuation of fiscal reforms with rationalization of tax structure; fillip to industry and infrastructure, fiscal incentives and concrete measures for transport, power, and other urban and rural infrastructure; measures for promotion of foreign direct investment in selected sectors, including defense manufacturing and insurance; and, steps to augment low cost long-term foreign borrowings by Indian companies. Fiscal reforms have been bolstered further by the recent deregulation of diesel prices. The launch of 'Make in India' global initiative is intended to invite both domestic and foreign investors to invest in India. The aim of the programme is to project India as an investment destination and develop, promote and market India as a leading manufacturing destination and as a hub for design and information. The programme further aims to radically improve the Ease of Doing Business, open FDI regime, improve the quality of infrastructure and make India a globally competitive manufacturing destination.

Some of the initiatives taken or announced were thematically in continuation of the post liberalization banking reforms. This would include improving of governance, strengthening stressed assets resolution and recovery mechanism, etc. New initiatives, too, like getting started on differentiated bank licensing. Also in FY15, financial institutions are taking concrete steps to deal with digital technologies and their potential for disruption. Some initiatives taken by financial service sector are as follows:

New banks, New types

The Reserve Bank of India awarded universal bank licences to two entities, infra financier IDFC and micro lender Bandhan Financial Services. Also for the first time, RBI opened the sector for differentiated bank licenses. Big corporate entities like Reliance, Bharti Airtel and the Aditya Birla Group had applied for payment banks. RBI is in the process of vetting the bids and is expected to award licenses in the next few months.

Governance

Recommendations of the P J Nayak committee to review governance issues in banks has been started for the reform process. The Narendra Modi-led government has already split the chairman and managing director's post in public sector banks and invited applications from those in private banks to head the state-run ones, at market-linked pay.

Capital infusion in Government banks

Public sector banks reeling under the pressure of stressed assets have seen their capital position worsening due to higher provisioning. Their capital raising ability from the market is also constrained due to poor valuations. However, breaking the tradition of infusing capital in banks that need it most, the government decided to do so in banks which are more efficiently run, sending a signal that banks must be run efficiently to survive.

Infra financing

The central bank has allowed banks to raise funds via long-term bonds for financing to the infrastructure sector. For these, they don't have to meet the cash reserve ratio, statutory liquidity ratio or priority sector norms. This will help lenders to boost infrastructure and affordable housing financing. In

addition, banks are now allowed to refinance core sector projects every five years for four times, the '5/25 rule', helping lenders to address their asset liability issues.

Growth

Amid a slowing economy, when interest rates are high (RBI has reduced the policy rate by 50 basis points only since January), bank loan growth was the slowest in more than a decade. According to RBI data, loan growth till March 6 was 10.2 per cent (year on year) as compared to 14.3 per cent in the same period of the previous year. Deposit growth also slowed in the year, at 11.6 per cent as compared to 15.1 per cent the previous year.

FDI in insurance

A new pro-business government at the Centre also ensured the long-pending proposal of higher foreign direct investment in the insurance sector getting lawmakers' approval. Many foreign insurers which have 24 per cent in their insurance venture in India said they'd raise it to 49 per cent, as regulations permit now.

ROAD AHEAD

India is today one of the most vibrant global economies, on the back of robust banking and insurance sectors. The country is projected to become the fifth largest banking sector globally by 2020. It is expected that bank credit will grow at a compound annual growth rate of 17 per cent in the medium term leading to better credit penetration. The banking industry saw significant policy changes during the past year, the most prominent among them being deregulation of deposit savings account rates, the introduction of the Marginal Standing Facility and the Government's policy on Financial Holding Companies. The liquidity deficit has increased significantly; it is not a pressing concern. Management of NPA is the major challenge likely to face the banking sector next year, with slowing growth hitting the top and bottom lines of the industrial sectors. Therefore, further disclosures relating to transparency in concentration of assets and large exposures need to be put in place. Despite the economic challenges faced by the Indian banking industry, it has fared well with its strong credit and deposit growth, but these seem to be moderating and are expected to be temperate in the current calendar year. Life Insurance Council, the industry body of life insurers in the country also projects a growth rate of 12–15 per cent over the next few years for the financial services segment.

Also, the relaxation of foreign investment rules has received a positive response from the insurance sector, with many companies announcing plans to increase their stakes in joint ventures with Indian companies. Over the coming quarters there could be a series of joint venture deals between global insurance giants and local players.

CONCLUSION

Economic growth and sustainable development are not zero sum games. They are both prerequisites of the future we want, mutually reinforcing, and neither can succeed in the absence of the other. Sustainable growth strengthens all three pillars of development – economic, social, and environmental and recognizes that long-term prosperity requires a careful

balance between benefits reaped today and ensuring the well-being of our people and our planet tomorrow. Ultimately it is a concept grounded in intergenerational equity. The objectives and priorities of the international community and the business world are more aligned than ever before, for business to enjoy sustained growth, we need to build trust and legitimacy and for markets to expand in a sustainable way, we must provide those currently excluded with better and more opportunities to improve their livelihoods. This is why the private sector is such a central partner as we shape the post-2015 development agenda, and in India it is why business must pay a key role in helping us implement and achieve the new sustainable development goals.

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