Indian Financial System: 
A Young Entrepreneur's Dilemmas

Subodh Agarwal is basking in excitement ahead of the scheduled meeting with his financial consultants - his first business meeting after the entrepreneur bug had bitten him at MIT. Upon completing bachelor's in chemical technology, he joined MIT for his masters in the same arena. While in the college, he identified huge market for artificial leather in Western markets, thanks to the nature protection groups that are cultivating anti-leather sentiments among customers. His initial research showed that producing in India and exporting to the Western markets would be far more rewarding.

Hailing from a business family, he is blessed with all the riches that a rich kid could aspire for. However, he wants to start this venture on his own not taking even the seed capital from his father's 'family business’. He is ideology driven but also pragmatic. He strongly believes in knowing all the nuances of managing a business and he wants to begin with understanding the Indian business environment with specific reference to the Indian financial system. He is sure that the product will click and therefore arranging for the required funds would not be difficult. However, lot has changed in the Indian financial system in the last 7 years since he left India for his studies at MIT. Indian capital markets have become more vibrant with new financing instruments being added and the existing financial instruments’ reach has been widened. The regulators too have become proactive in predicting and preempting any financial wrongdoing with their watchful eyes cast over financial markets. For the project to kick start its operations, he needs to scout for the right finance from the right source for the right duration. Who is going to help him out?

On keenly scrutinising all the consulting firms available in the city, Subodh chose one 'New India Venture Associates' that is led by Aushotosh Rane, a Chartered Accountant. and his only brief to them was, “I want to start a business and want to know the ABCs one must be aware of and follow in this regard.” The carrot from the aspirant entrepreneur was, “if I am impressed with you in this meeting, the relation will last longer”.

The consultants prepared the following PPT and Aushotosh Rane, himself made the presentation.
Indian Financial System

A presentation by
Aushotosh Rane
Chief Operating Officer

New India Venture Associates

Financial System

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Financial System Objectives

- Economic Growth
- Capital Formation
- Investments
- Savings

Indian Economy at Independence

- Independence from the British in 1947
- One of the poorest countries in the world
- Agriculture contributed to nearly 90% of the economy
- Home for one of the oldest stock exchanges in the world
- Equity culture among the Rich urbanites
Economic Progress
Pre-Liberalisation (1947–1991)

- Adoption of mixed economic model – Capitalism and Socialism
- Fairly stable political system for most of the years
- License raj – Red tape, Corruption and Bureaucratic regime
- Dominance by public sector and few business families presence in the private sector
- Enactment of Companies Act in 1956

Contd...

Economic Progress
Pre-Liberalisation (1947–1991)

- Average GDP growth (1947–1980) - 3.5%
- Average GDP growth (1980–1990) - 5.6 %
- One investment institution – UTI (1964)
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**Economic Change: Post-Liberalisation**

- Liberalisation started in 1991 after a severe balance of payments crisis
- Opening of the economy for foreign players
- Encouraging active private participation
- Phenomenal growth of the Indian Economy
- Average GDP growth (1991–2005) - 5.9% (Amongst the highest in the world)
- GDP growth 2006–2008 - above 8% (Second only to China)

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**Today’s Economic Picture**

As on March 31, 2008

- GDP - $1.237 trillion (est.)
- GDP Growth - 7.3% (2007–2008)
- Contribution of Agriculture - 17.2%
- Contribution of Manufacturing Sector - 29.1%
- Contribution of Services sector - 53.7%
- Trade Deficit - $111.8 billion

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Today’s Economic Picture

- Forex Reserves - $254.6 billion as on December 31st 2008
- Per Capita Income - $1,200 (approx)
- FI Investments - $751.14 billion
- FDI Investments - $142.9 billion
- Fiscal Deficit - 10.3% of GDP
- Total Market Capitalization – INR 53,093.19 trillion as on March 31st 2008
- External Debt - $230.85 billion as on December 31st 2008

Contd...

Today’s Economic Picture

- RS/ $ - 49.34 (As on May 14th 2009)
- Repo rate - 4.75% (mid April 2009)
- Reverse Repo - 3.25% (mid April 2009)
- PLR Rate - 12.75–13.25% (mid April 2009)
- Bank Rate - 6% (mid April, 2009)
- CRR - 5% (mid April 2009)
- SLR - 24% (mid April 2009)
Recent Events

- Global Financial Crisis leading to global slowdown
- Indian growth forecasts revised downwards from 8% to 5.5%
- Business sentiment low
- Inflation at all time low at -0.33% (mid April 2009)
- Sensex - 12031 (May 13th 2009)

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Regulatory Environment

Major Regulatory Bodies

- RBI – Banking, Foreign Exchange, Debt Market
- SEBI – Capital Markets
- IRDA – Insurance

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Regulations

Companies Act 1956
This is the basic law which governs the creation, continuation, the winding up of companies. It also governs the relationships between the shareholders, the company, the public and the government. It also addresses other statutes dealing with corporate entities.

RBI Act 1934
The act deals with incorporation, capital, management and business of RBI.

Contd...

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Regulations

Banking Regulation Act 1949
The act deals with the business of banking companies, (setting up if banks, monitoring the compliance requirements, borrowings and investments supervision, etc)

Contd...

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New Industrial Policy – 1991
A. Industrial Licensing
B. Foreign Investment
C. Foreign Technology Agreements
D. Public Sector Policy
E. The Monopolistic and Restrictive Trade Practices (MRTP) Act

Contd...

Regulations

Competition Act 2002
This Act was enacted in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

Contd...
Regulations

FEMA Act 2002
The law relating to exchange control in India has undergone a substantial change in scope, content and approach by the substitution of the Foreign Exchange Regulation (FERA) Act, 1973 by the Foreign Exchange Management (FEMA) Act, 1999. The most noticeable aspect of FEMA is that there is no imprisonment prescribed for contraventions of the law, not even as an alternative punishment and for blatant and deliberate violations.

Contd...

Regulations

FEMA Act of 2002
FEMA was executed with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

Contd...
Regulations

Securities and Exchange Board of India (SEBI) Act of 1992

The basic objectives of SEBI include:

- To protect the interests of investors in securities
- To promote the development of Securities Market
- To regulate the securities market and
- For matters connected therewith or incidental thereto.

Forms of Business Organisation

- Sole Proprietor
- Partnership
- Hindu Undivided Family (HUF)
- Cooperative Society
- Private Limited Company
- Public Limited Company
- Government Company
- Public Sector Undertaking
- Government-owned Company
- Corporation (LIC)
- Trust (UTI)
Financial Institutions

Reserve Bank of India (RBI): Central Bank
1) Commercial Banks - Public Banks, Private
Banks - New Generation Private Banks, Old
Generation Private Banks, Foreign Banks
2) Development Financial Institutions:
   a. All India level - IFCI and IIBI
   b. State level - SIDBI and SFC
3) Specialized Institutions: NHB, EXIM, NABARD, ECGC
4) Insurance: Public - LIC and GIC, Private - HDFC
   Standard Life, ICICI Lombard
5) Mutual Funds – UTI and other Mutual Funds like
   Religare Mutual Fund, Birla Sun Life mutual fund
6) NBFCs

Financial Markets and Instruments

Classification based on term to maturity of the
instrument

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<tr>
<th>Purpose</th>
<th>Players</th>
<th>Regulators</th>
</tr>
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<tbody>
<tr>
<td>Money Market</td>
<td>Short-term rupee finance</td>
<td>Banks, Government, FIs, Corporates, FIs, MFs, Individuals</td>
</tr>
<tr>
<td>Capital Market</td>
<td>Long-term rupee finance</td>
<td>Corporates, Banks, FIs, Individuals, MFs, FIs</td>
</tr>
</tbody>
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### Financial Market Participants

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<thead>
<tr>
<th>Intermediary</th>
<th>Market</th>
<th>Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Exchange</td>
<td>Capital Market</td>
<td>Secondary market to securities</td>
</tr>
<tr>
<td>Investment Bankers</td>
<td>Capital Market, Credit Market</td>
<td>Corporate advisory services, issue of securities</td>
</tr>
<tr>
<td>Underwriters</td>
<td>Capital Market, Money Market</td>
<td>Subscribe to unsubscribed portion of securities</td>
</tr>
<tr>
<td>Registrars, Depositories, Custodians</td>
<td>Capital Market</td>
<td>Issue securities to the investors on behalf of the company and handle share transfer activity</td>
</tr>
<tr>
<td>Primary Dealers</td>
<td>Money Market</td>
<td>Market making in government securities</td>
</tr>
</tbody>
</table>

### Money Market Players and their roles

<table>
<thead>
<tr>
<th>Player</th>
<th>Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Bank</td>
<td>Intermediary/Regulatory</td>
</tr>
<tr>
<td>Government</td>
<td>Borrower/Issuer</td>
</tr>
<tr>
<td>Banks</td>
<td>Borrowers/issuers</td>
</tr>
<tr>
<td>Discount Houses</td>
<td>Market Makers</td>
</tr>
<tr>
<td>Acceptance Houses</td>
<td>Market Makers</td>
</tr>
<tr>
<td>FIs</td>
<td>Borrowers/issuers</td>
</tr>
<tr>
<td>FIs</td>
<td>Investors</td>
</tr>
<tr>
<td>Dealers</td>
<td>Intermediaries</td>
</tr>
<tr>
<td>Corporates</td>
<td>Issuers</td>
</tr>
</tbody>
</table>

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Money Market Instruments

**Government and Quasi-government Securities**
- Treasury Bills (T-Bills)

**Banking Sector Securities**
- Call and Notice Money Market
- Term Money Market
- Certificates of Deposit
- Participation Certificates.

**Private Sector Securities**
- Commercial Paper
- Bills of Exchange (commercial and trade bills/merchant bills)
- Inter-Corporate Deposits/Investments
- Money Market Mutual Funds
- Bonds/Debentures by the corporate.

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Capital Market Intermediaries

- Merchant Bankers
- Registrars and Share Transfer Agents
- Brokers
- Bankers to the issue
- Debenture Trustees
- Underwriters
- Portfolio Managers
- Mutual Funds and Venture Capital Funds
- Depositories
- Custodians of Securities and Depository Participants
- Foreign Institutional Investors
- Collective investment schemes like plantation schemes.
For further details:
feel free to contact us at
http://www.newindiaventureassociates.co.in

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Having listened to the consultant’s presentation, Subodh made some notes and wanted further clarity on certain issues. His questions were:

1. What exactly is the financial system and what is its relevance?
2. What are the major changes in the Indian economy over the years? Will the transformation aid me also in my business? If yes, how? If no, why not?
3. What kind of financing difficulties would I find when I start my business now? What are the current challenges in the Indian financial market?
4. How long do I have to wait before the economy turns positive? Which are the institutions responsible for bringing back the economy on track and what are the regulations that govern them? What methods are these institutions taking up to ensure early recovery?
5. What are the various regulations which my business has to comply with? Under what circumstances will my business be subjected to each of the regulations?
6. If I want to start an SME, what procedures would be necessary?
7. What is the purpose of having so many financial institutions? How different are they from one another?
8. What are the different avenues available for raising capital and what would be the ideal way to raise money for my business?
9. Who are the major operators in the Indian capital market and what are their distinct roles?
10. How strong and effective is Indian capital market?

Mr. Asutosh patiently answered all the queries and elaborated in detail on important points and gave his frank view on each of his query. After getting clarity Subodh thanked Ashutosh and walked out of his office feeling better having got to understand the Indian business environment with specifics on Indian financial system.