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FINANCIAL SERVICES

Unit 1 - Financial services

Financial services - meaning

Financial service is one of the component of the financial system, Lets look at the meaning and its importance.

Financial service is part of financial system that provides different types of finance through various credit instruments, financial products and services. In financial instruments, we come across cheques, bills, promissory notes, debt instruments, letter of credit, etc.

In financial products, we come across different types of mutual funds. extending various types of investment opportunities. In addition, there are also products such as credit cards, debit cards, etc.

In services we have leasing, factoring, hire purchase finance etc., through which various types of assets can be acquired either for ownership or on lease. There are different types of leases as well as factoring too.

Thus, financial services enable the user to obtain any asset on credit, according to his convenience and at a reasonable interest rate.

Features of Financial Services

1. Financial services are Intangible
2. Financial services are customer oriented
3. The production and delivery of a service are simultaneous functions therefor are inseparable
4. They are perishable in nature and cannot be stored
5. They are dynamic in nature as a financial service varies with the changing requirements of the customer and the socio-economic environment. – must be dynamic socio economic changes, disposable income
6. They are proactive in nature and help to visualize the expectations of the market
7. They acts as link between the investor and borrower
8. They aid in distribution of risks

Importance of Financial services

It is the presence of financial services that enables a country to improve its economic condition whereby there is more production in all the sectors leading to economic growth.

The benefit of economic growth is reflected on the people in the form of economic prosperity wherein the individual enjoys higher standard of living. It is here the financial services enable an individual to acquire or obtain various consumer products through hire purchase. In the process, there are a number of financial institutions which also earn profits. The presence of these financial institutions promote investment, production, saving etc.

Hence, we can bring out the importance of financial services in the following points:

1. Promoting investment
The presence of financial services creates more demand for products and the producer, in order to meet the demand from the consumer goes for more investment. At this stage, the financial services comes to the rescue of the investor such as merchant banker through the new issue market, enabling the producer to raise capital.

The stock market helps in mobilizing more funds by the investor. Investments from abroad is attracted. Factoring and leasing companies, both domestic and foreign enable the producer not only to sell the products but also to acquire modern machinery/technology for further production.

2. Promoting savings
Financial services such as mutual funds provide ample opportunity for different types of saving. In fact, different types of investment options are made available for the convenience of pensioners as well as aged people so that they can be assured of a reasonable return on investment without much risks.

For people interested in the growth of their savings, various reinvestment opportunities are provided. The laws enacted by the government regulate the working of various financial services in such a way that the interests of the public who save through these financial institutions are highly protected.

Financial Services offered by various financial institutions

- Factoring.
- Leasing.
- Forfeiting.
- Hire Purchase Finance.
- Credit card.
- Merchant Banking.
- Book Building.

- Asset Liability Management.
- Housing Finance.
- Portfolio Finance.
- Underwriting.
- Credit Rating.
- Interest & Credit Swap.
- Mutual Fund.

3. Minimizing the risks
The risks of both financial services as well as producers are minimized by the presence of insurance companies. Various types of risks are covered which not only offer protection from the fluctuating business conditions but also from risks caused by natural calamities. Insurance is not only a source of finance but also a source of savings, besides minimizing the risks. Taking this aspect into account, the government has not only privatized the life insurance but also set up a regulatory authority for the insurance companies known as IRDA, 1999 (Insurance Regulatory and Development Authority) .

4. Maximizing the Returns
The presence of financial services enables businessmen to maximize their returns. This is possible due to the availability of credit at a reasonable rate. Producers can avail various types of credit facilities for acquiring assets. In certain cases, they can even go for leasing of certain assets of very high value.

Factoring companies enable the seller as well as producer to increase their turnover which also increases the profit. Even under stiff competition, the producers will be in a position to sell their products at a low margin. With a higher turnover of stocks, they are able to maximize their return.

5. Ensures greater Yield
As seen already, there is a subtle difference between return and yield. It is the yield which attracts more producers to enter the market and increase their production to meet the demands of the consumer. The financial services enable the producer to not only earn more profits but also maximize their wealth.

Financial services enhance their goodwill and induce them to go in for diversification. The stock market and the different types of derivative market provide ample opportunities to get a higher yield for the investor.

6. Economic growth
The development of all the sectors is essential for the development of the economy. The financial services ensure equal distribution of funds to all the three sectors namely, primary, secondary and tertiary so that activities are spread over in a balanced manner in all the three sectors. This brings in a balanced growth of the economy as a result of which employment opportunities are improved.

The tertiary or service sector not only grows and this growth is an
important sign of development of any economy. In a well developed country, service sector plays a major role and it contributes more to the economy than the other two sectors.

7. Economic development
Financial services enable the consumers to obtain different types of products and services by which they can improve their standard of living. Purchase of car, house and other essential as well as luxurious items is made possible through hire purchase, leasing and housing finance companies. Thus, the consumer is compelled to save while he enjoys the benefits of the assets which he has acquired with the help of financial services.

8. Benefit to Government
The presence of financial services enables the government to raise both short-term and long-term funds to meet both revenue and capital expenditure. Through the money market, government raises short term funds by the issue of Treasury Bills. These are purchased by commercial banks from out of their depositors' money.

In addition to this, the government is able to raise long-term funds by the sale of government securities in the securities market which forms apart of financial market. Even foreign exchange requirements of the government can be met in the foreign exchange market.
The most important benefit for any government is the raising of finance without offering any security. In this way, the financial services are a big boon to the government.

9. Expands activities of Financial Institutions
The presence of financial services enables financial institutions to not only raise finance but also get an opportunity to disburse their funds in the most profitable manner. Mutual funds, factoring, credit cards, hire purchase finance are some of the services which get financed by financial institutions.

The financial institutions are in a position to expand their activities and thus diversify the use of their funds for various activities. This ensures economic dynamism.

10. Capital Market
One of the barometers of any economy is the presence of a vibrant capital market. If there is hectic activity in the capital market, then it is an indication of the presence of a positive economic condition. The financial services ensure that all the companies are able to acquire adequate funds to boost production and to reap more profits eventually.

In the absence of financial services, there will be paucity of funds which will adversely affect the working of companies and will only result in a negative growth of the capital market. When the capital market is more active, funds from foreign countries also flow in. Hence, the changes in capital market is mainly due to the availability of financial services.

11. Promotion of Domestic and Foreign Trade
Financial services ensure promotion of domestic as well as foreign trade. The presence of factoring and forfaiting companies ensures increasing sale of goods in the domestic market and export of goods in the foreign market. Banking and insurance services further contribute to step up such promotional activities.

12. Balanced Regional development
The government monitors the growth of economy and regions that remain backward economically are given fiscal and monetary benefits through tax and cheaper credit by which more investment is promoted. This generates more production, employment, income, demand and ultimately increase in prices.

The producers will earn more profits and can expand their activities further. So, the presence of financial services helps backward regions to develop and catch up with the rest of the country that has developed already.

Types of Financial Services

Capital market Services – It consists of consist of term lending institutions which mainly provide long term funds.
Money market Services – It consists of commercial banks, financial institutions, co-operative banks which providing short term funds agencies
Retail Service – Services provided to individuals for direct consumption.
Wholesale Service – Services provided to corporate institutions which may be directly or indirectly converted into retail services.
Fund Based Services – It refers to services that are used to acquire assets or funds for a customer. It consists of –

– Primary market activities
– Secondary market activities
– Foreign exchange activities
– Specialized financial Services

Important fund based services include –

- Leasing
- Hire purchase
- Factoring
- Forfeiting
- Mutual funds
- Bill discounting
- Credit Financing
- Housing Finance
- Venture capital

Fee based services – When financial institutions operate in specialised fields to earn income in form of fees, commission, brokerage or dividends it is called a Fee based Service. They include –

Issue Management
Portfolio management
Corporate counseling
Merchant banking
Credit rating
Stock broking
Capital restructuring
Bank Guarantee
Letter of Credit
Debt Restructuring

Types of Financial Activities

Fund based Activities –

Underwriting or investment in shares, debentures, bonds, etc. of new issues (Primary Market Activities)
Dealing in secondary market activities
Participating in money market instruments eg. Discounting bills, treasury bills, certificate of deposit etc.
Involving in equipment leasing, hire purchase, venture capitals
Dealing in foreign exchange activities

Fee based Activities –

Managing the capital issue in accordance with SEBI guidelines enabling promoters to market their issue
Making arrangements for placement of capital and debt instruments with investment institutions
Arrangement of funds from financial institutions for clients project cost or working capital
Assisting in getting all Government and other clearances

Modern Activities –

Rendering project advisory services right from the preparation of the project report till raising of funds
Planning for Memorandum and Articles of Association and assisting for their smooth carry out
Guiding Corporate Customers in capital restructuring
Acting as trustees to the debenture holders
Recommending changes in managing structure and style
Structuring financial collaboration/Joint Venture by identifying partners and preparing Joint Venture agreements

Rehabilitating and Restructuring sick companies
Hedging of risks by using swaps and other derivative products
Managing the portfolio of large public sector corporations
Undertaking risk management services eg. Insurance, buy back options
Advising clients
Promoting credit rating agencies
Minimizing cost of debt and determining optimum debt equity ratio
Undertaking capital market services –

New financial products and services:-

Payments and transfers	▪ Cash/ATM ▪ Check ▪ Wire/MTO ▪ Debit/Credit cards	➢ Mobile payments, mobile money, mobile PoS ➢ Peer-to-peer (P2P) payments ➢ Business-to-business (B2B) transactions ➢ Digital wallets, e-wallets, mobile wallets ➢ Digital money, virtual currencies
Savings and investments	▪ Bank deposits ▪ Mutual funds ▪ Bonds ▪ Equities	➢ Mobile banking ➢ Micro-saving and micro-investing apps ➢ Mobile market funds ➢ Blockchain stocks and bonds ➢ Online brokers ➢ Mobile trading ➢ Crowdinvesting or equity crowdfunding ➢ Social trading
Borrowing and financing	▪ Bank loan ▪ Microcredit and microloans ▪ Bonds ▪ Mortgages ▪ Trade credit	➢ Crowdsourcing and alternative financing ➢ Crowdfunding (crowdlending, P2P lending, social lending) ➢ Online business lending ➢ Blockchain bonds ➢ Electronic or e-leasing ➢ Electronic or e-invoicing ➢ Electronic or e-factoring

Innovative financial instruments

Innovative financial instruments are a range of activities such as :

- participation in equity (risk capital) funds
- guarantees to local banks lending to a large number of final beneficiaries, for instance small and medium-sized enterprises (SMEs)
- risk-sharing with financial institutions to boost investment in large infrastructure projects (e.g. the Europe 2020 project bonds initiative or the connecting europe facility financial instruments).

The aim is to boost the real economy through increasing the access to finance for enterprises and industry producing goods and services. Spending through innovative financial instruments is another way of spending EU budget than giving grants or subsidies.

Challenges faced in the financial service sector

1.Cybercrime in Finance

Data breaches involving financial service firms increased by 480% from 2017 to 2018. With each attack costing financial institutions millions, innovative solutions are needed if we are to avoid a repeat of the lawless days of the Wild West.

Whatever cybercrime solutions emerge to protect financial services, blockchain technology must be the foundation.

Integrating DLT with existing financial infrastructures poses some serious obstacles that must be overcome.

2. Regulatory Compliance in Finance
The ever-changing regulatory environment poses a constant challenge for financial institutions of all types.

Regtech is an emerging industry that can help ease the burden of compliance. By using the latest FinTech technologies to address regulatory compliance, RegTech startups are bridging the gap between regulators and the financial service industry.

Automated reporting, automated audits, and process streamlining are only a few of the benefits offered by RegTech applications.

3. Big Data Use in Finance
Big data provides both opportunities and obstacles for financial service providers. Tapping into social media, consumer databases, and even news feeds can help banks better serve their customers, while better protecting their own interests.Fortunately, data analytics solutions are emerging with the potential to transform asset management, trading, risk management, and other financial services.

4. AI Use in Finance
Industry experts believe that AI will transform nearly every aspect of the financial service industry. Automated wealth management, customer verification, and open banking all provide opportunities for AI solution providers.

But that’s all been said before. So why should we expect AI to keep that promise now?

Powerful advances in deep learning technology are paving the way for AI. In fact, if you have been alerted by your bank of suspicious activity on your account, you have likely already benefited from AI.

The challenge that financial services face is learning how to benefit from the power of AI, without being victimized by it. In R&D labs across the world, that question is being pondered at this very moment.

5. Fintech Disruption of the Financial Service Industry
Penetration of Fintech among the US Financial Sector (a sample of 1300 companies)

Those pesky little FinTech companies that appeared less than a decade ago have not gone away, as many in the banking industry had hoped. On the contrary. Many have matured into formidable rivals for customers and the cash they bring to the table.

Realizing that partnering with these tech-savvy startups might be more prudent than opposing them, 64% of financial service leaders say they plan to collaborate with FinTechs in the future. Wise move.

6. Customer Retention in the Financial Services Industry
Competition for financial service clients has never been fiercer. While brand loyalty may not be dead, it is definitely on life support.
What matters to most customers in this year is greater personalization, more automated services, and easier access to services. Institutions that can deliver all three will capture their share of the market.
Key to not losing the battle is recognizing that customers are less concerned with brand familiarity than getting the services they want. Providing customers those services is key to client retention.

7. Employee Retention in the Financial Service Industry
Today’s financial service companies not only find it difficult to attract customers, but they are also finding it difficult to attract employees.
A lack of qualified talent to fill new IT roles, and a millennial workforce that shuns long-term employment, are leading factors in finding good help.
Institutions that want to attract and retain a qualified workforce must change their philosophy. No longer is it enough to offer good pay and benefits; workers now expect employers to nurture a culture that is accommodating to the values and lifestyles of the employee.
Change is necessary if stable and qualified workforces are to be achieved. But don’t expect it to come easy.

8. Blockchain Integration in Finance
We talked earlier about blockchain as a key component in the battle against cybercrime. But data security is not the only application for blockchains in the financial sector.
Far from it, cases across the globe are already proving the value of blockchain in a wide variety of banking and investment applications. From solving challenges faced by investment banks to helping customers make safer payment transactions, the list is growing daily.