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Globalization of Finance and Its Implications for the Stabilization of Industries of India

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Abstract: The financial system has benefited from the Globalization of financial markets and financial Institutions. Financial globalization may also create new risks to the stability of the financial system. This Article analyses the impact of four major factors on the financial stability. These factors includes the Rapid race of Innovation in financial markets, the increased Globalization of the banking system, the broadening of the Non-Banking Investor based and changes in the Regional Regime. The risks and benefits forwarded by these developments on financial stability are assessed in the light of their impact on the main core functions of the financial system. This article starts by analyzing the sources of strength and risk to financial stability from Innovation in the financial markets.

Keywords: Financial stability, Global Banks, Non-Banking Investors.

INTRODUCTION

In this article the sources of strength and risk to financial stability for Innovation in the financial markets. The analysis sounds to the impact on financial stability of Global Banks and other players in the financial systems. The aiming of increasing the soundness of Individual Institutions may create perverse conditions that contribute to financial stability following and adverse shock. Financial markets are rapidly evolving in terms of a product Innovation, Technology Adoption and Geographic and sectorial integration. The Rapid Evolution of financial markets presents both benefits & Risks to market participants Institutions, and the financial system as a whole. This section analysis how the Innovation in and the Globalization of financial markets might have contributed to enhance the financial stability while creating New sources of Risk. Financial market innovation has contributed to enhanced risk management in the financial system. Financial innovations such as credit derivatives, structured finance, and securitization Techniques have helped to reduce the concentration of risk among the financial Intermediaries. The Transfer markets continuous to evolve rapidly, attracting Investors other than Financial Institutions.

REDUCED VOLATALITY

The globalization of financial markets may also contributed to reduce market volatility due to increased liquidity, a Plausible stabilizing role played by institutional Investors, more efficient price discovery and the availability of more Instruments for corporations to Examine its financial operations in the industry.

CONSEQUENCES OF GLOBALIZATION

The Implications of Globalization for a National economy are many. Globalization has intensified interdependence and competition between Economies in the world markets. This is reflected in Interdependence in regard to Trading in Goods & services and in movement of capital. As a result Domestic Economic developments are not determined entirely by Domestic policies, market conditions. Rather they are influenced by both domestic and International policies and economic conditions. It is thus clear that Globalizing Economy, while formulating and Evaluating its Domestic policy cannot afford to ignore the possible actions and reactions of the Policies and developments in the rest of the world. This constrained the policy option available to the Government which implies loss of policy autonomy to some extent, in decision making at the national level.

IMPACT OF GLOBALIZATION IN INDUSTRIAL SECTOR

The effects of Globalization of Indian industry started when the government opened vistas for foreign Investments in the early 1990's when the Globalization of the Indian Industries took place in its various sectors like steel, Pharmaceuticals, Petroleum, Chemicals, textiles, Cement, Retail etc., Globalization means the dismantling of the Trade barriers, between nations and this helped to provide employment to many people in the country. This helped to reduce the level of unemployment and poverty in the country. Also the benefits of effects of Globalization on Indian Industry and the foreign companies brought in highly advanced technology with them and this helped to make the Indian industry more technologically advanced.

IMPACT OF FINANCIAL SECTOR

Reforms of the financial sector constitute the most important component of Indians programme towards economic liberalization. The recent economic liberalization measures have opened the door to foreign competitors to enter in to our domestic markets. Innovation is a must for survival in 21st century. Financial intermediaries have come out of their traditional approach and they are ready to assume more credit risks. The emergences of various financial institution and regular bodies have transformed the financial service sector from being conservational to a very dynamic one. In this process this sector is facing a number of challenges. In this changed context the financial services industry in India has to play a very positive and dynamic role in the years to come by offering many innovative products to suit the varied requirements of the millions of prospective investors spread throughout the country.

The Indian economy has experienced major policy changes in the early 1990's. The new economic reforms, popularly known as LPG aimed at making the Indian economy as a fast growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well as financial sectors aimed at making the economy more efficient with the onset of reforms to liberalize the Indian economy in July 1991, a new chapter has dawned for India. This period of economic transition has had a tremendous impact on the overall economic development of all most all sectors of the economy and its effects over the last decade can hardly be over looked. Besides it is also marks the advent of the real integration of the Indian economy in to global economy.

The era of reforms has also ushered in a remarkable change in the Indian mindset as it deviates from traditional values held since independence in 1947, such as self-reliance and socialistic policies of economic development, which mainly due to the inward looking restrictive form of governance, resulted in the isolation, overall backwardness and inefficiency of the economy, amongst host of other problems. This despite the fact that India always had the potential to be on the fast track to prosperity. India is now in the process of restructuring its economy, with aspirations of elevating itself from the present desolate position in the world; the need to spread up its development is even more imperative and having witnessed the positive role that foreign direct investment (FDI) has played in the rapid economic growth of the most Asian countries. India has embarked on an ambitious plan to emulate the successes of her neighbors trying to sell itself as a safe and profitable destination for FDI. The process of globalization not only includes opening of a world trade development of advanced means of communication, internalization of financial markets, growing importance for MNC's. In the context of India, this implies opening up the economy to FDI by providing facilities to foreign companies to invest in different fields of Indian economy in India.

THE PROSPECTS OF GLOBALISATION

Implication there is an international market for companies and for customers, with a wide range of products. There is an increase in the flow of investments from developed countries to developing countries used for economic reconstruction greater and faster flow of information between countries and greater culture interaction helped to overcome culture barriers. Technological developments has resulted more quality productivity with less cost.

POTENTIAL RISK TO FINANCIAL BENEFITS

Historical evidence suggests that financial markets are intrinsically fragile. Furthermore, the increased importance of non-financial intermediaries vis-à-vis banking intermediaries could lead to less frequent but more several financial crises as financial intermediaries are forced to liquidate their at fire –sale prices.

SELF SUSTAINING PRICES DYNAMICS

From the financial stability perspective one main concern is whether liquidity will be enough, to keep markets working smoothly during the period market distress. In the absence of liquidity, the clearing and settlement systems could choke, risk management strategies relying on market transactions could stop being effective and prices could diverge substantially from their fundamental values as markets because one sided. The nature of the market liquidity is to a large degree endogenous and subject to the behavior of the market participants. In financial markets there is a substantial scope for the existence perverse self-sustaining price dynamics during the period of falling prices and liquidity. One major source of shrinking self-sustaining price dynamics is the feedback effect generated by dynamic hedging strategies of market participants.

CONTAGION

Increased cross market linkages through new financial instruments and cross market investment strategies raise the risk of contagion spillovers across markets and across countries. Cross market linkages and transmission mechanisms contribute to a faster propagation of negative shocks team of positive shocks across international markets. Markets hence because more unstable during the periods of distress. Finally, it is important to note that there is an increased reliance of a limited number of counter parties in financial markets, especially for the more complex financial instruments such as derivatives and structured products. This situation creates the risk of a domino effect in case of a major counter party default and in policy circles, raises the specter of the moral hazard problem associated with valuing complex financial instruments remains a major challenge even among sophisticated market participants. Validating pricing model is difficult since there is a scarce data for newly introduced financial instruments. Model risk for complex instruments carries over to how best to manage exposure to these instruments, since by necessity hedging is model based.

CORPORATE GOVERNANCE AND ASYMATRIC INFORMATION PROBLEMS

The investment function is generally performed through delegated management, it is important that risks associated with different financial instruments are adequately understood by the top management. There is a need to have independent risk management systems and strict internal controls to traders and portfolio management. Financial innovation and increased risk transfer have a perverse way of unveiling weakness in the corporate governance of financial institutions.

THE GLOBALISATION OF THE BANKING SYSTEM

The overall impact of globalization of the banking system on financial stability. The globalization of the banking system has been driven by three major trends.

a) Internalization of the banking business
b) Consolidation
c) Conglomeration

THE DIVERSIFICATION OF BENEFITS OF A GLOBALISED BANKING SYSTEM

The internalization of the banking system has increased global competition for scarce lending opportunities. Arguably competition strengthens market discipline and to a certain extent, complements prudential capital market regulations. Internalization is being driven by the quest for higher profitability pockets and perceived regulatory advantages. Cross border consolidation help to lower risks in the banking sector, since mergers and acquisitions provides operational hedges through diversification that either substitute or complement financial hedging.

Finally, conglomeration is arguably encouraged by lower technology costs, the need to provide clients with a diverse mix of services and the gains obtained from economies of scale. It is not clear, however, whether increased conglomeration has resulted in gains in efficiency. The globalization has helped mostly to diversify risks through acquisitions, the internalization of the business operations and conglomerations. An important source of diversification has been increased involvement banks in non-bank activities, especially insurance that helps to reduce their bankruptcy risk.

RISKS TO FINANCIAL STABILITY

From the perspective of the financial system, there are a number of arguments that suggest that the globalization of banking could increase systematic risk. Indeed, there is an empirical evidence that while banks may benefit from diversification in normal times. Consolidation gains are offset to some degree by increase in counter party risk as the banking system evolves towards a system involving a few large players active across different markets. Consolidation does not remove the inherent fragility of the banking system. Recently, banks have become a major source of capital and brokerage services to hedge funds. Increased linkages of banks and hedge funds raise the concern as to whether problems in hedge funds could spill over to the banking sector.

THE BROADENING OF THE INVESTOR BASE BEYOND BANKING INSTITUTIONS

The growing diversification of the non bank investor base could be a potential stabilizing force to the extent that it creates heterogeneity of views and actions. The non-bank investor base has a different investment needs than banks and is subjected to a different regulatory regime, or as in the case of hedging funds, lightly regulated. Regulatory differences could help to ensure a minimum level of heterogeneity among the investor base through increased consolidation of banks and non banks in to single institutions may work against it. This article supports that the impact of financial stability of four types of institutional investors deemed systematic. A) Pension funds b) insurance companies c) mutual funds d) hedge funds.

MARKET BASED CAPITAL ADEQUACY REQUIREMNTS

Regulatory trends have encouraged the adoption of market Based risk management and information systems. The ongoing implementation of the Basel II frame work as the minimum standard for capital adequacy in banks and ongoing work on solvency for establishing a risk based solvency capital requirement for insurance companies aim to align capital requirements with the underlying risks financial institutions face in their business activities. By emphasizing the use of market prices rather than book values, regulators expect that the information disclosed by financial institutions and other market participants will be more transparent and will capture better economic value and risks of their port folios.

CONCLUSION

This paper assessed financial globalization from the financial stability perspective. Financial globalization has opened up opportunities and brought substantial benefits. It has also created additional transmission channels for shocks to be amplified that could under some circumstances, pose a risk to financial stability. The regulatory and legal frame works could also limits the diversity of views of market participants and restricts their range of responses during a period of distress and further contributes to the smooth functioning of the markets.

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