

## **Innovations in Investment Products and its Impact on Financial Services Sector**

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### **ABSTRACT**

*As a developing nation India's progress is very satisfactory and days are not far when we will be counted among the developed nations. Innovative Idea has been implemented to reap the harvest of this fast growth. Financial Service sector has also witnessed innovations and modification in Products and Processes. Ever changing technological advancements have impacted everyone. Financial Investments options have seen huge changes in the last 16 years, they are much more attractive as compared with the products from the past. These Innovations and modifications in investment products have changed our way of looking at investments. Impact of these innovations on social and economic fabric of the country had been tremendous. Someone once said, "A country is as rich as its citizens." The way to become rich is investment in products with good returns. Investment products have always been a matter of solicitation, especially products which have a return source other than interest. Technological advancement and modification, new and innovative products as investment options seem to be forcing the realignment of financial transaction systems. As we are still talking about Financial Inclusions in our country. The author intends to explore the major innovation and modifications in three Investment Products namely Mutual Funds, Life Insurance and Stock Markets participations of Individual Investors. In this research paper an attempt is made to try and understand the Impact of these Innovations on growth of these products and Financial Service Sector.*

**Keywords:** Innovations, Modifications, Financial Inclusion, Mutual Funds, Life Insurance, Stock Markets, Investment Products, Financial Service Sector.

### **INTRODUCTION:**

After 26 years of liberalization and 70 years of Independence, India is now matching the economic growth of the best in the world. The growth of 7.6% in GDP during the year 2015-16 made us the fastest growing economy surpassing China. We are now a key player in the Global Financial Market.

In the last 70 years of Independence, Indian economy has undergone huge transformations or should we say reforms. It can be explained in three stages. The first stage reforms are year marked from 1947 – 1991. This was a period when India got independence. Despite of having resources we were one of the poor countries of the world. There was a huge gap between have and have not's. It was clear the private sector would invest only in that area where they could make profit. The country was struggling with poverty, hunger, basic Infrastructure, unemployment etc in such a situation our leaders opted for a Mixed Economy. The second stage of reforms period were year marked from 1991 – 2016. This was a time when India was having a huge balance of payment crisis. As a developing country we needed to import Capital Goods and Fuel leading to more imports than exports. On 24<sup>th</sup> July 1991, 34 Sectors of the Indian economy were opened for private and foreign investors. This marked the departure from Mixed to Capitalist Economy. Some of our eminent economist and thinkers on

this subject now argue that with Demonetization and GST implementation we have entered the third stage of reforms starting Nov 2016.

Innovations and reforms have been a part of Indian economy for the last 26 years .One of the sector which has witnessed these changes and played an important role in the growth story of our country is “Financial Services Sector”. India is a country with a population of 132.4 crores, while 67 % population still living in villages having literacy rate of 71% in rural areas and 86% in urban areas .India’s average literacy rate of 72.1 %. As compared to China which is 96.4%, Sri Lanka 92.6%, Brazil with 92.6 %. Access to financial services is subjected to various factors such as financial literacy, income levels and financial assets held by urban and rural households, which bears inconsistency across rural households in case of our country. In India, with approximately 48% financial literacy i.e less than half of the population, it becomes necessary to prioritize financial inclusion to promote economic growth. Whereas financial literacy in countries like Sri Lanka, Malaysia, Korea is much higher.

### **OBJECTIVES OF STUDY:**

- To understand the journey of Investment products and road ahead.
- To explore the innovations and modifications in investment products namely Life insurance, Mutual Funds and Stock Markets in last 16 years.
- To analyse the impact of these innovations on the growth of these products.
- To study impact of innovations on Financial Services Sector.

### **LITERATURE REVIEW:**

With the intention to understand the thoughts of scholars on topic related to innovation and financial services sector literature review was undertaken.

PWC (2014,) in a report published mentions innovations as, “the key element in providing aggressive top- line growth and for increasing bottom line results. Companies cannot grow through cost reduction and reengineering alone.” The economics of the industry are changing at first pace financial institution with traditional processes and product have started facing tough competitions from technologically advanced new market participants how believe in innovations. According to this report few financial institutions are reluctant to embrace innovations, as these believe that innovation means complete transformation in the process and structure of the organization. The fact is that at any level of the organisation innovation can be introduced and implemented with or without investments. Innovation may require introduction of new process, operating models, technologies at division, business units or enterprise level as the situation may demand. These misconceptions have prevented organizations in implement innovative strategies .

M.B. Shukla (2012) in his book “Indian Economy” writes the role of innovation in acceleration of growth , optimum utilization of resources , overcoming resource constraints and helping the countries in using it synergies and energies is recognized worldwide . “Innovation is already contributing significantly to the growth of the economy and dynamism of industry”.

Hari Narayan, Chairman IRDA (2011), “Future success of the life insurance profession depends, above all , upon the knowledge and integrity of the people who advice customers- and are their first , and most important, point of contact” .

Daniel Fasnacht (2009) in his “Open Innovation in the Financial Services” has tried to define Innovation. The term innovation have different understanding to different people it is because of this reasons that a wide variety of interpretations are found. Latin verb Innovare means “to make something new”. Innovation is synonymous to anything which is new or carries ingredients of novelty. In the context of business it means introduction of new product or a new service, or improving existing things with the objective of creating an impact in the market. However innovation is not only used in products and services but can take place in strategies, paradigms and strategies. “Innovation comes in many different forms, from the truly revolutionary to the almost mundane. It involves the creation of new designs and ways of doing things, their commercial exploitation, and subsequent diffusion through the rest of the economy and society. Innovation is one of the main engines of long-run economic growth and structural change and has always driven economic progress”.

Indian Institute of Banking & Finance (2009) book published with title “Inclusive Growth Thro’ Business Correspondent” states that “financial literacy is the ability or understanding to make informed judgments about money or financial services that are suited to one’s needs. Unwillingness on the part of individuals to save is possibly the most adverse impact of lack of financial literacy. In an income and saving Survey, it was found that, of over 320 million paid workforces in India ,close to 60 percent do not set aside any money to save in

financial instruments, Including gold and property”.

V S Ramaswamy & S Namakumari. (2009) in their work on “Marketing Management” mentions that “the market for a product is nothing but the aggregate of the consumers of that product. We also know that consumer of a product vary in needs, motives, characteristic, and buying behaviour”.

Raghubendra Jha (2008) in his book “The Indian Economy: Current Performance and Short-Term Prospects” mentions the because of continuous deprivation the poor are not in a position to take the advantages of the growth in the economy due to economic reforms. This is a similar situation which existed in the past as well, some sectors were artificially protected but even then they failed to take advantage of these sectors. Thus the poor have less participation in the progress and success of economic reforms. “In a democratic country such as India, this means that political parties espousing pro-reform policies may not necessarily win elections. This could emerge as a significant constraint on rapid economic growth in India”

## **RESEARCH METHODOLOGY:**

To understand the major innovation in three investment products and the affect it had on financial services sector this study was undertaken based on secondary data. Since it is a descriptive analysis of what have already been achieved most of the data and charts are from the past studies. Inferences and conclusion deduced are base on the past studies and present situation prevailing in that particular area of study.

### **Innovation and Financial Services Sector:**

Growth of financial sector is much talked and spoken about since a long time. Innovations and Modifications have become the order of the day. Are we really growing fast? The distance we covered in the last 70 years of independence is not in line with the expectations .Innovation is defined as a "new idea, device or method." It is a process through which an idea or invention is translated into goods and services for which the customer is ready to pay. Innovations are of two types: product innovation and process innovation. In the financial service sector, both types of innovation have taken place on a very large scale.

Modification on the other hand is a change to something, usually to improve it. Innovations in products or processes are traditionally done either to sustain the market share or expand it.

Technological advancements have impacted the financial service sector. Investment options have experienced tremendous change in the last 16 years. They are more attractive as compared to the products from the past. Innovations and modification in investment products have changed our perception about investments .The impact of these innovations on social and economic fabric of the country has been tremendous. Technological advancements and modifications, new and innovative products as investment options, seem to be forcing the realignment of financial transaction systems. As Investment products have always been a matter of solicitation, especially products with return sources other than interest. It has become even more important to understand the impact of Innovation. However, innovations both in products and processes have reinforced the need for continuous improvement in knowledge and skills set. Transition from traditional to a dynamic work culture is leading to unrest and gaps are showing up spring out issues and problems of the once who execute these innovation.

### **Innovation in Investment Products:**

In investment Products innovation involves repackaging, un-packaging and rebinding same characteristic of new or existing products to suit the changing need of the consumers and investors. It also includes the changes in the processes of delivery of the product and services with the intention to meet the customer satisfaction levels. Innovation includes significant improvements in characteristic of products and services. As investment products require solicitations, innovations in the methods and process of delivery have become a major component.

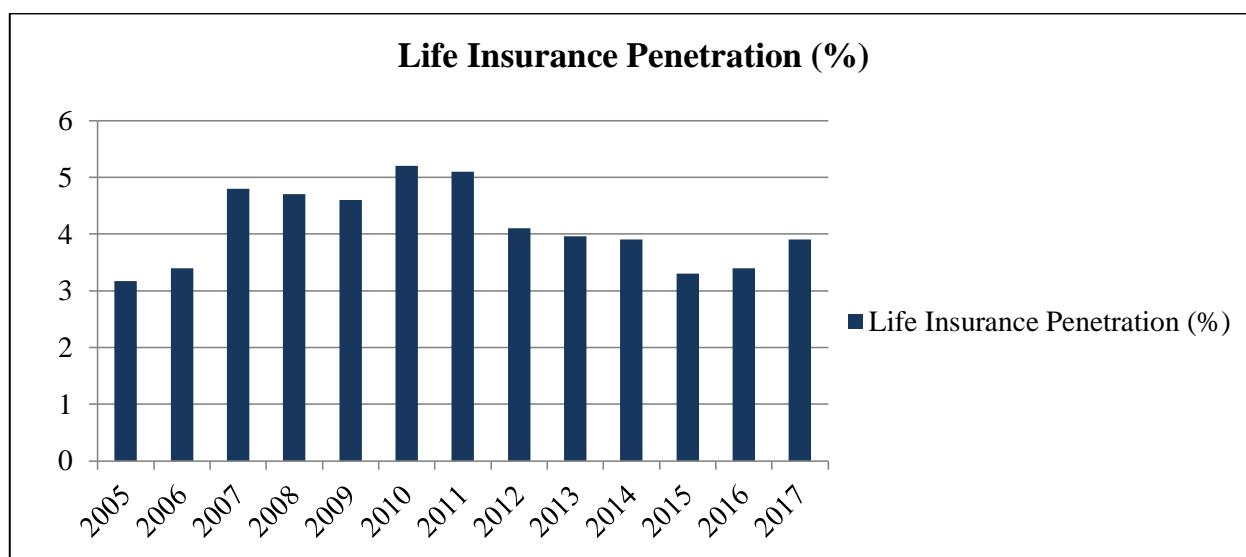
### **Life Insurance:**

Life Insurance pays a lump sum benefit on the death of the life insured . It provides protection for dependence from financial hardships in case of premature death of life insured. History of Life insurance in India dates back to 1818 when Oriental Life Insurance Company was founded. It was the first Life Insurance Company in India that was established in Calcutta<sup>10</sup>. Before 1956 India had 154 domestic life insurers 16 foreign life insurer and 75 provident funds. In 1956 LIC was founded by an act of parliament and all life insurance providers were nationalized and brought under one head i.e Life Insurance Corporation of India. On 7<sup>th</sup> Dec 1999 Insurance Regulatory and Development Authority (IRDA) Act was passed. This Act curtailed the monopoly conferred to the Life Insurance Corporation in 1956. Total Number of policies done by LIC till 31<sup>st</sup> March 2003 were 9.85

Crs and their advertisement released in Feb 2017 claims that they have sold 28.5 Crs policies.

In 2001 insurance sector was open for private and foreign investor. The first company permitted to start business was HDFC standard Life followed by ICICI Prudential. Currently there are 24 companies in the life Insurance sector. In the first decade of insurance sector liberalization, the sector reported consistent increase in insurance penetration from 2.71 percent in 2001 to 5.20 percent in 2009.

Liberalization has resulted in huge innovation of products, processes and distributions. Innovative Product like ULIPs, Term Insurance, High Liquidity Plans , Plans with low expenses ,Shorter premium paying terms, Top up options ,Partial Withdrawal option, Monthly mode of Premium Payment etc were introduced to attract more and more customer inspite of this insurance penetration have declined to 3.9 percent. Apparently in the case of Life insurance innovations are just methods of sustaining the correct scenario Data shows that the desired impact of innovation is not evident and the Life insurance penetration is going down at the same time consumer are moving back to traditional products even though the best products like ULIPs are available.



**Source:** Insurance Regulatory and Development Authority (IRDA) Data

### **Mutual Funds:**

The first introduction of mutual funds in India occurred in 1963, with the launch of UTI. It enjoyed a monopoly in the Indian mutual fund market until 1987. In 1996, SEBI, the regulator of mutual funds in India, formulated the Mutual Fund Regulation. There are 43 companies operating in the Mutual Fund space. AUM in 2004 was Rs 1.39 Cr. Despite being available in the market, less than 10% of Indian households have invested in mutual funds. The number of mutual funds schemes introduced till 2001 were 41 . By the end of January 2003, there were 33 Mutual funds with total assets of Rs. 1, 21,805 crores. The UTI with Rs.44, 541 crores of AUM was way ahead of other Mutual funds .The number of schemes introduced aird to 414 by the end of 2007. Mutual Fund AUM as on 31 Dec 2017 is Rs 21,26,665 Crs out of which Equity accounts for Rs 6,90,153<sup>11</sup>.Total Number of Folios till 31 Dec 2017 are 6,64,86,373. Individual investors held Rs.11.89 lakh crore in mutual funds as of January 2018, an increase of 49.9% over January 2017<sup>12</sup>.As on 31 Jan 2018 current AUM is Rs 23.25 lakh Crs and Indian Mutual Funds have currently about 1.97 crore (19.7 million) SIP accounts through which investors regularly invest in Indian Mutual Fund schemes<sup>13</sup>.

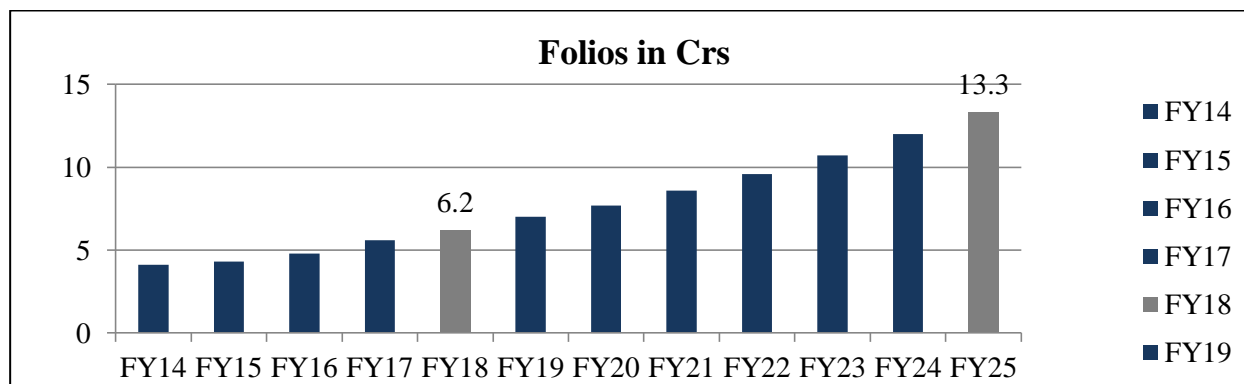
Since the year 2000, new a innovative products were launched e.g Infrastructure Debt Fund, Gold ETF, Fixed Maturity Plans, Fund of Funds, Capital Protection Scheme, Funds for overseas Investment, Thematic Funds , etc Investment process innovations done by removing entry load and introducing SIP, STP ,SWP , ECS, NEFT and RTGS for investing in Mutual Funds. These i mention to highlight few major innovations. Mutual funds have shown promising growth in terms of AUM is it because of these innovations or it is a result of market activities.

The next three years are predicted to be even more dynamic, as distribution platforms are continuously changing. Mobile applications and web based selling options are increasing on a daily basis. As on date there are more than 160 mobile applications related to investment options. Mass media advertisements and investor awareness programs are being conducted by AMFI on a regular basis. The expectation is that AUM will touch 41 lakhs Crs by 2021. To improve the reach of mutual funds in small cities/towns ,in September 2012 SEBI

allowed AMC's to charge additional expenses ratio upto 30bps on daily net assets for inflow beyond top 15 cities<sup>14</sup>. Current AUM contribution is 27% from these B15 cities.

AMFI reports point out that AUM may double in the next 3 years but doubling of folio will require 7 years which means there is huge growth rate difference in AUM and Folios. Even if we count to projected number of AMFI on the basis of one folio one individual (which is not the case) than to less than 10% population will be covered by 2025.

In some advanced countries, mutual fund AUM is in multiple of bank deposits. In India, mutual fund AUM is only about 12.5% of bank deposits. This is indicative of the immense potential for growth of the industry<sup>15</sup>.



**Source:** Association of Mutual Funds of India(AMFI) Report

### Stock Markets of India:

A stock exchange provides companies with a facility to raise capital for expansion through selling shares to the investing public<sup>16</sup>. The history of Stock Exchanges in the world is 201 years old. It was 1817 when NYSE started operations and trading started. India has the oldest stock exchange in Asia i.e. Bombay Stock Exchange (BSE) established in 1875 with the name "the native share and stock brokers Association". There are a total of 21 stock exchanges in India, with the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) being the largest. Both offer stocks with volume and opportunity as India and the exchanges continue to grow and attract foreign investment<sup>17</sup>. Currently there are 7 active stock exchanges in India. On SEBI website Magadha exchange is listed but it is clearly mentioned that its renewal has been refused by SEBI.

Active stock exchanges are -

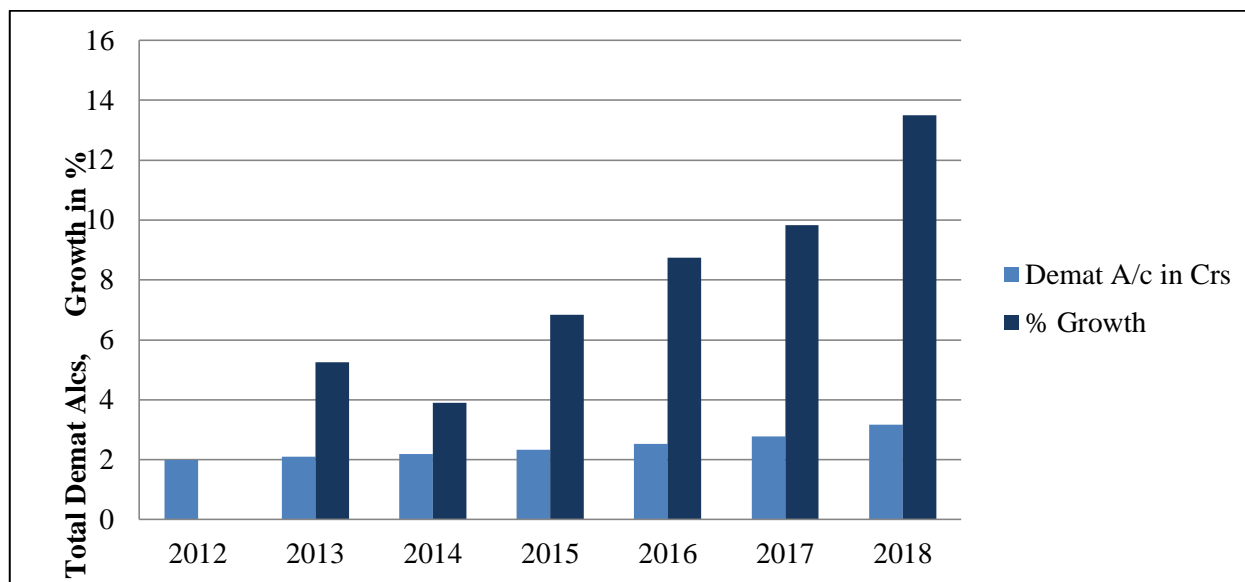
1. Ahmadabad Stock Exchange Ltd.
2. BSE Ltd.
3. Calcutta Stock Exchange Ltd.
4. India International Exchange (India INX)
5. Metropolitan Stock Exchange of India Ltd.
6. National Stock Exchange of India Ltd.
7. NSE IFSC Ltd<sup>18</sup>

Although stock market in India are the oldest in Asia dating back to 1874 as compared to 1878 of Tokyo Stock Exchange, the process of modernization and computerization started pretty late in 1994. But in a short span of less than ten years, the market have undergone a sea change<sup>19</sup>.

As a scholar of Economics Dr Manmohan Singh knew the Stock Markets are best indicators of economy for the outer world and should give a fair direction of the moods of investors. At that point BSE was the most popular Stock exchange but the style and functioning was primitive and it was tough and time taking to transform BSE into State of Arts Exchange so it was decided the NSE will be created. NSE was incorporated in 1992. It was recognized as a stock exchange by SEBI in April 1993 and commenced operations in 1994 with the launch of the wholesale debt market, followed shortly after by the launch of the cash market segment<sup>20</sup>.

Stock Market have played an important role in the development of an economy not only by playing a role of capital market but also the best source of wealth creator. NSE was created with the purpose improving the financial well-being of people. Two Depositories were created. NSDL was created on 8 Aug 1996 and CDSL was created Feb 1999. Main function of depository is to hold securities either in certificated or uncertificated form, to enable book entry transfer of securities. Internet trading started in India on 1<sup>st</sup> April 2000 as many as 79 members sought the permission to do so.

Innovation and modification have been an integral part of stock exchange, being most dynamic investment option with systematic and unsystematic risks. The market regulator SEBI has also been very active to act and react in different situation. Apart from providing best online and offline Trading Platform a number of innovative products have being introduced in the stock markets e.g single stock future and options, index options based on the NIFTY 50 index, ETFs Listing, launch of web based trading platforms, trading in currency futures, trading platform for mobile etc Total Number of Demat Accounts opened by NSDL are 1.699 Crs and by CDSL are 1.462 Crs till 28<sup>th</sup> Feb 2018.



Source: CDSL & NSDL Data. Figures till 28<sup>th</sup> Feb 2018

Since 2012 there has not been a major innovation in the type of products offered by the stock exchange or depositories. There have been a few changes in the process. It means that the growth in number of Demat accounts is mainly due to the market performance and not a result of innovations.

### Financial Inclusion and Investment Products:

The introduction of these innovative investment products has changed the dynamics of financial service sector to a very large extent. Although these products were targeted towards urban and rural market both but till date rural markets have remained untapped. This has happened because the concentration of distribution activities by some players is only in urban Markets. Rural households have traditionally been investing in bank deposits, post office and LIC policies<sup>21</sup>. Growing network of banks in the rural areas has propelled the availability of the products as banks are also selling them as corporate agents. The rise in income levels of rural and semi-urban population in India indicates strong future potential for investment products.

Financial sector regulators Reserve Bank of India (RBI), Insurance Regulatory & Development Authority (IRDA) and Securities and Exchange Board of India (SEBI) have initiated policies for smooth distribution of financial products and services. IRDA has made mandatory for new players to maintain a certain proportion of life insurance to be sold in rural areas thereby forcing private player to open service points in rural areas. From 2006 onwards RBI has approved setting up 50% of new branches in unbanked areas.

Government is making all efforts to accelerate the pace of financial inclusion but in a country like India where more than 50 % population is financial illiterate it's a big task.

Financial Inclusion till date has been the sole responsibility of the Public Sector entities in the financial services sector. Public sector banks, LIC, UTI mutual fund have the largest number of branches in semi urban and rural areas. The IBA-BCG survey of banks revealed that the level of confidence in finding profitable solutions for financial inclusion is not very high<sup>22</sup>. Government's focus on financial inclusion and inclusive growth seems to have expedited the pace of activities. Participants of financial services sector are now working on innovative model to translate the government's vision on inclusive growth.

### Financial Service Sector and Innovation in Investment Products:

Economic reforms, which started in 1992, lead to the dynamic growth of this sector making this sector not the

only one but the most important sector of the economy. Contribution of 6% of the GDP Financial Service sector still holds the key of economic growth. Unlike in the past, when financial services sector mainly constituted of the banking sector, today financial sector has broadened its reach to include sectors like insurance services, non-banking financial services, co-operatives, pension funds, mutual funds, capital market etc.

Innovations in Investment products have been happenings at all levels be it be products, processes or delivery. It has forced financial service sector to realign itself by 360 degrees. Reports published by different authorities and regulators also indicate that these innovations have accelerated the growth of this financial service sector. Inspite of all this Life insurance penetration is 3.9 percent. Mutual funds have 6.64 Crores folios till Dec2017 and total Demat accounts are only 3.161 Crores till Jan 2017. According to one estimate, financial services sector have created more than 2.00 Crores on roll and off role jobs in the last 15 years. The potential of financial services sector is huge and more than 80% of investment products still needs to be tapped but the sector is showing signs of overheating and maturity, which ideally should not be the case at this point in time. Authorities agree that there is a huge potential for investment products but, ironically, mutual funds and life insurance have started showing signs of maturity

### **SUMMARY OF FINDINGS:**

70 years post independence, we have tried various economic models in three stages but result of these reforms is still far from the target. Where 28 Crore population is still below poverty line, 20 Crore population does not have access to banking and ATMs. Financial literacy of India is 48% lesser than Sri Lanka, North Korea and Brazil etc. The time is ripe for a critical analysis of target verses achievement, in financial services sector.

As the doors of Indian Economy have been opened to the world, matching the world's best management styles and products is the need of the hour. Innovations will continue to happen. The challenge of realigning our systems and strategies, has pushed the agenda of strengthening the rural economy, to the back seat.

The regulators are micro managing the Investment businesses in the name of customer protection and changing regulations on a daily basis. The companies are busy working on alternate business models which can bring down operating cost, leaving very little room for increasing the geographical coverage and doing investor awareness programs.

Innovations should help in sustaining the markets or increasing the market of that product and to a certain extent it has been done. So is in the case of investment products. But at the same time it has also created invisible barriers which need to be analyzed and removed before it increases the gap between have and have not's.

Financial Inclusion is a buzz word these days but very little has been achieved in the real sense as rural economy is not in a good shape. At the same time government initiative also did not yield the desired result.

### **CONCLUSIONS:**

One of the reasons of re-form in Financial Services Sector will be innovation in investments products. As we try to match the global products and management standards new products and easy processes will continue to flow into our lives. Investments have always been a matter of solicitations, any change in the products or processes, need clarifications before decision making. In our country there are lack resources to cover the entire length and breadth with financial services and more than half of the population still needs to learn about investments. Innovations have complicated the situation which is very evident in life insurance business as ULIPS are losing to traditional products. Similar situation is emerging in Mutual funds as SEBI has directed all AMCs to merge similar schemes and rename those schemes where the motive of the scheme is not clear from its name. Innovations in Investment products alone has not helped in expanding the market but there are some other important factors as well like Market performance, political stability, use of new technologies and platforms of investment etc.

Financial Services sector have been accepting innovations in products and processes since more than 16 years but signs of unrest have started showing as bankers going on nationwide strike in March this year. It's time to do some out of the box thinking before it is too late.

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