



An analysis of the role of Shadow Banking in India and the Challenges it confronts

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ABSTRACT

Although shadow banks may be traced back to the 1970s, they have grown significantly in recent decades in emerging nations. Similar expansion in shadow banks has also been observed in India. The term shadow banking firstly coined by the Paul Mc. Culley in 2007. Shadow banking is occurred and exists in all economies. Shadow banking are worked as a financial intermediation which include all activities performed outside the regular banking system. The last two to three decades, the financial sector has witnessed a lot of changes and growing competition. Many shadow banking companies are the subsidiary company whose parent company is traditional bank. In the financial crises of 2008, shadow banks play important role in housing credit and their size is increased. This Paper's objectives are to investigate the Role and Challenges of shadow banking in India.

Key words: - Shadow banking, financial sector, Non-banking financial companies, and financial crises.

INTRODUCTION

The shadow banking sector includes a wide range of markets and institutions. They may invest in money market and hedge market, as well as private equity and special purpose corporations. Shadow banking is a universal phenomenon. In developing countries the activities of shadow banking are supplementary to the regular banking system. They rise short term funds from the market and invest in long term funds. In shadow banking we include entities shown in figure.

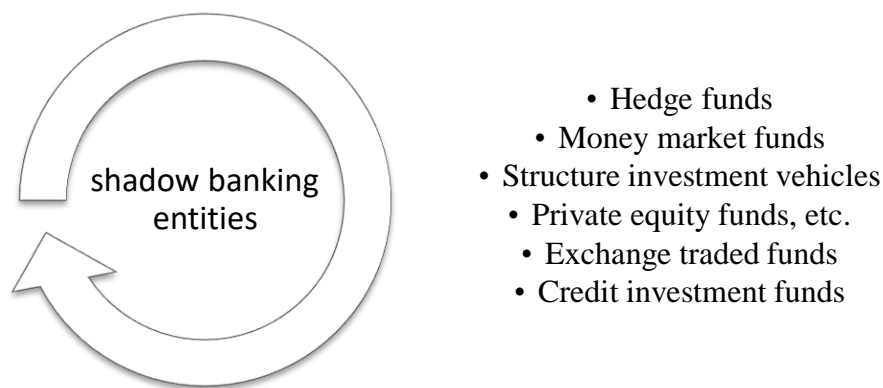


Figure 1:- Shadow Banking Entities

Shadow banking institutions are companies that work like bank, acts like bank and behave like bank. Hence the question that arises is whether it is a bank. Often, it is not a bank—it is a shadow bank (The Reserve Bank of India, 2014). The term —Shadow Bank was coined by economist Paul McCulley in a 2007 speech at the annual financial symposium hosted by the Kansas City Federal Reserve Bank in Jackson Hole, Wyoming who defined shadow banks as- “The Whole Alphabet Soup of Levered Up Non-Bank Investment Conduits, Vehicles And Structure”. However, the Financial Stability Board, which defined ‘Shadow Banking’ as the “Credit intermediation involving entities and activities (fully or partially) outside the regular banking system”. In the financial crises of 2008, shadow banks play important role in housing credit and their size is increased. Like traditional banks they do not accept and hold deposit from ordinary consumer which helps the shadow banks from the regulation of government.

ROLE OF SHADOW BANKING IN INDIA

In India Shadow Banking system operates as non-banking financial institutions which are called NBFC. Compared to the foreign countries the size of the NBFC is smaller in India. Because they have to work under the conservative banking practices and regulatory surveillance. The 2008 financial crisis, however, demonstrated that shadow banking can pose a systemic risk to the banking system. Risks can be transmitted both directly and indirectly via the interconnectivity of insufficiently regulated firms with the banking system.

Following the financial crisis, central banks around the world, particularly those in the United States, the United Kingdom, and the European Union (EU), implemented a slew of tough measures to rein in shadow banking. In India, the NBFC crisis, sparked by IL&FS's liquidity concerns in 2018, has refocused attention on the shadow banking sector. India's financial sector is diversified and expanding rapidly. It is comprised of commercial banks, insurance companies, non-banking financial companies, cooperatives, pension funds, mutual funds and other smaller financial entities (Deepak, 2013). Many nonbank financing businesses (NBFCs) specialize in specific areas (leasing, factoring, microfinance, and infrastructure finance), while some take deposits.

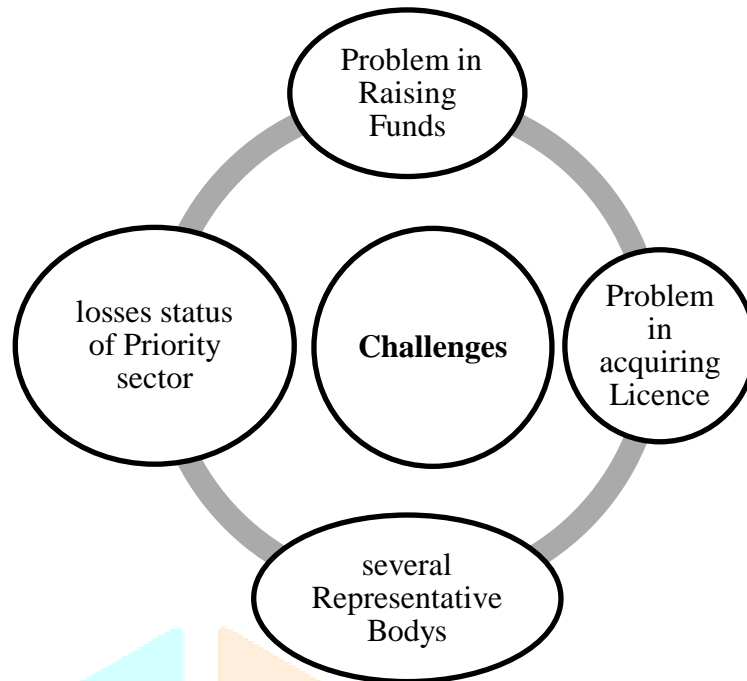
CHALLENGES OF SHADOW BANKING IN INDIA

Figure 2:- Challenges of Shadow Banking in India

- 1) **Problem in Raising Funds:** - Banks in India have numerous refinancing possibilities. They can refinance from many sectors and bank etc. But NBFCs are depend only on banks or the capital markets to raise funds. This is unfavourable to the NBFCs for their growth and expansion.
- 2) **Problem in acquiring Licence:** - The process of obtaining licence for NBFC licence is fairly complicated. They have to get approval from Reserve Bank of India and complete many documents. On the other hand, it necessary for the NBFC to follow the prescribed process of RBI to registered.
- 3) **Several Representative Bodies:** - There are several representative bodies which control the NBFCs. It should be noted that the NBFCs sector is still in its early. As a result, establishing a single representative body may be a good for their growth and expansion.
- 4) **Losses status of priority Sector:** - The main challenge faced by the NBFCs is priority sector status to bank lending to NBFCs. It should be restored for their growth and expansion. It will help the NBFCs to create their wealth and asset in rural area of the country.

CONCLUSION

Our analysis reveals that shadow banking works as an inter-link between investors, commercial banks and person who want financial assistance. The shadow banking sector is an extremely diverse group of institutions. It involved hedge funds, money market funds, credit investment funds etc. In India shadow banks play important role in providing loan to such peoples who does not meet the requirement of traditional banks. The played a vital role in meeting the financial need of a person of a remote village as well as the need of big manufacturing industry. It provides an alternative source of fundings and liquidity. It becomes a source of systemic risk both directly or indirectly with regular banking systems. It is important that to grow the size of shadow banking government should give more concern. The main focus of the

Reserve bank is to streamlining to the regulation of NBFCs and to protect the customer's interest. In India, there are many incorporated or unincorporated companies which are registered as a finance companies but these are not regulated by the reserve bank of India. This big challenge for the India to streamline these finance companies.

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