Overview of Indian Financial System

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Introduction

The financial system of a country is an important tool for economic development of the country as it helps in the creation of wealth by linking savings with investments. It facilitates the flow of funds from the households (savers) to business firms (investors) to aid in wealth creation and development of both the parties. The institutional arrangements include all condition and mechanism governing the production, distribution, exchange and holding of financial assets or instruments of all kinds. There are four main constituents of the financial system as follows:

1. Financial Services
2. Financial Assets/Instruments
3. Financial Markets
4. Financial Intermediaries

Financial Services

Financial Services is concerned with the design and delivery of financial instruments, advisory services to individuals and businesses within the area of banking and related institutions, personal financial planning, leasing, investment, assets, insurance etc. These services include

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- **Banking Services:** Includes all the operations provided by the banks including to the simple deposit and withdrawal of money to the issue of loans, credit cards etc.
- **Foreign Exchange services:** Includes the currency exchange, foreign exchange banking or the wire transfer.
- **Investment Services:** It generally includes the asset management, hedge fund management and the custody services.
- **Insurance Services:** It deals with the selling of insurance policies, brokerages, insurance underwriting or the reinsurance.
- Some of the other services include advisory services, venture capital, angel investment etc.

Financial Instruments/Assets

Financial Instruments can be defined as a market for short-term money and financial assets that is a substitute for money. The term short-term means generally a period of one year substitutes for money is used to denote any financial asset which can be quickly converted into money. Some of the important instruments are as follows:

- **Call /Notice-Money:** Call/Notice money is the money borrowed on demand for a very short period. When money is lent for a day it is known as Call Money. Intervening holidays and Sunday are excluded for this purpose. Thus money borrowed on a day and repaid on the next working day is Call Money. When the money is borrowed or lent for more than a day up to 14 days it is called Notice Money. No collateral security is required to cover these transactions.
- **Term Money:** Deposits with maturity period beyond 14 days is referred to as the term money. The entry restrictions are the same as that of Call/Notice Money, the specified entities not allowed to lend beyond 14 days.
- **Treasury Bills:** Treasury Bills are short-term (up to one year) borrowing instruments of the union government. It's a promise by the Government to pay the stated sum after the expiry of the stated period from the date of issue (less than one year). They are issued at a discount off the face value and on maturity, the face value is paid to the holder.
- **Certificate of Deposits:** Certificates of Deposits is a money market instrument issued in dematerialized form or as a Promissory Note

for funds deposited at a bank, other eligible financial institution for a specified period.

- **Commercial Paper:** CP is a note in evidence of the debt obligation of the issuer. On issuing commercial paper the debt is transformed into an instrument. CP is an unsecured promissory note privately placed with investors at a discount rate of face value determined by market forces.

Financial Markets

The financial markets are classified into two groups:

Capital Market:

A capital market is an organized market which provides long-term finance for business. Capital Market also refers to the facilities and institutional arrangements for borrowing and lending long-term funds. Capital Market is divided into three groups:

- **Corporate Securities Market:** Corporate securities are equity and preference shares, debentures and bonds of companies. The corporate security market is a very sensitive and active market. It can be divided into two groups: primary and secondary.
- **Government Securities Market:** In this market government securities are bought and sold. The securities are issued in the form of bonds and credit notes. The buyers of such securities are Banks, Insurance Companies, Provident funds, RBI and Individuals.
- **Long-Term Loans Market:** Banks and Financial institutions that provide long-term loans to firms for modernization, expansion and diversification of business. Long-Term Loan Market can be divided into Term Loans Market, Mortgages Market and Financial Guarantees Market.

Money Market

Money Market is the market for short-term funds. The money market is divided into two types: Unorganized and Organized Money Market.

- **Unorganized Market:** It consists of Moneylenders, Indigenous Bankers, Chit Funds, etc.
- **Organized Money Market:** It consists of Treasury Bills, Commercial Paper, Certificate Of Deposit, Call Money Market and Commercial Bill Market. Organized Markets work as per the rules and regulations of RBI. RBI controls the Organized Financial Market in India.

Financial Intermediaries

A financial intermediary is an institution which connects the deficit and surplus money. The best example of an intermediary is a bank which transforms the bank deposits to bank loans. The role of the financial intermediary is to distribute funds from people who have an extra inflow of money to those who don't have enough money to fulfil the needs. Functions of Financial Intermediary are as follows:

- **Maturity transformation:** Deals with the conversion of short-term liabilities to long-term assets.
- **Risk transformation:** Conversion of risky investments into relatively risk-free ones.
- **Convenience denomination**: It is a way of matching small deposits with large loans and large deposits with small loans.

Financial Intermediaries are divided into two types:

Depository institutions: These are banks and credit unions that collect money from the public and use that money to advance loans to financial customers.

Non-Depository institutions: These are brokerage firms, insurance and mutual funds companies that cannot collect money deposits but can sell financial products to financial customers.

Conclusion

Indian Financial System accelerates the rate and volume of savings through the provision of various financial instruments and efficient mobilization of savings. It aids in increasing the national output of the country by providing funds to corporate customers to expand their respective business. It helps economic development and raising the standard of living of people and promotes the development of the weaker section of society through rural development banks and co-operative societies. These are the important facts about the Indian Financial system.