UNIT 4 INDIAN FINANCIAL SYSTEM

4.1 INTRODUCTION

The economic development of any country depends upon the existence of a well organized financial system. It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promotes the well being and standard of living of the people of a country. Thus, the 'financial system' is a broader term which brings under its fold the (i) financial markets made up of capital/ securities market, money market and foreign exchange market, (ii) the financial institutions/intermediaries like banks, mutual funds, insurance companies and so on which support the system by collecting funds from the savers/investors and distribute them to the entrepreneurs for the productive ventures, and (iii) financial assets such as shares, debentures, derivative and so on. An efficient financial system facilitates the free flow of funds to more productive activities and thus promotes investment. Thus, the financial system provides the intermediation between savers and investors which in turn stimulate the capital formation and ultimately promotes faster economic growth.

4.2 LEARNING OBJECTIVES

After reading this unit, you should be able to

- Discuss the functions of Indian financial system.
- Know the structure of Indian financial system.
- Classify financial among various dimensions.
- Understand how Capital Market plays an important role in resource allocation.
- Discuss the growth and weakness of Indian financial system.

4.3 FINANCIAL SYSTEM: MEANING AND DEFINITIONS

A financial system functions as an intermediary between savers and investors. It facilitates the flow of funds from the areas of surplus to the areas of deficit. It is concerned about the money, credit and finance. These three parts are very closely interrelated with each other and depend on each other. A financial system may be defined as a set of institutions, instruments and markets which promotes savings and channels them to their most efficient use. It consists of individuals (savers), intermediaries, markets and users of savings (investors). In the worlds of Van Horne, "financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption".

According to Prasanna Chandra, "financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provide the principal means by which savings are transformed into investments". Thus financial system is a set of complex and closely interlinked financial institutions, financial markets, financial instruments and services which facilitate the transfer of funds. Financial institutions mobilise funds from suppliers and provide these funds to those who demand them. Similarly, the financial markets are also required for movement of funds from savers to intermediaries and from intermediaries to investors. In short, financial system is a mechanism by which savings are transformed into investments.

4.4 FUNCTIONS OF FINANCIAL SYSTEM

The main functions of a financial system which contributed for the economic growth may be briefly discussed as below:

1. Saving function: Most important function of a financial system is to link savers and investors and, thereby, help in mobilising funds and channelize them to productive activities efficiently and effectively. It is through financial system that savings are transformed into investments.

2. Liquidity function: The important function of a financial system is to provide money and monetary assets for the production of goods and services. Monetary assets are those which can be converted into cash easily without loss of value. All activities in a financial system are related to liquidity-either provision of liquidity or trading in liquidity.

3. Payment function: The financial system offers a very convenient mode of payment for goods and services. The cheque system and credit/debit card system are the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.

4. Risk function: The financial markets provide protection against life, health and income risks. These guarantees are accomplished through the sale of life, health insurance and property insurance policies.

5. Information function: A financial system makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.

6. Transfer function: A financial system provides a mechanism for the transfer of the resources across geographic boundaries.

7. Reformatory functions: A financial system undertaking the functions of developing, introducing innovative financial assets/instruments services and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).

8. Other functions: It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

4.5 STRUCTURE OF INDIAN FINANCIAL SYSTEM

The financial structure/ organisation of financial system consist of (1). Financial instruments (2). Financial Institutions (3). Financial markets (4). Financial Services

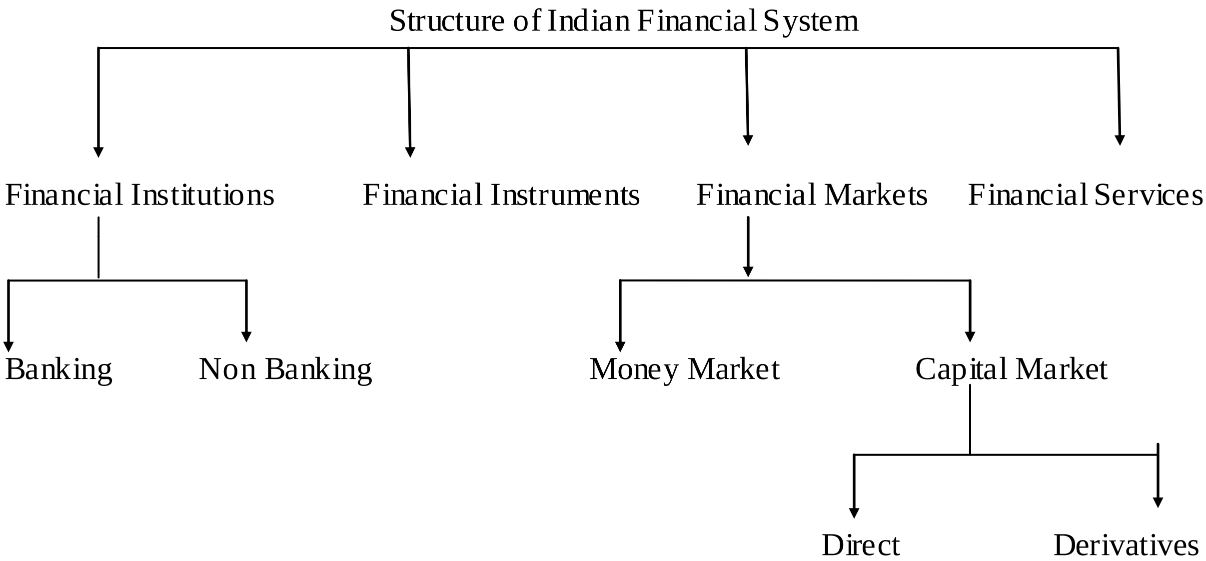


Fig 4.1 Structure of Indian Financial System

Source: D.K Murthy, Venugopal

Let us discuss each component of Financial System to understand its importance in the Indian economy.

4.6 FINANCIAL INSTRUMENTS/ ASSETS (SECURITIES)

Financial instruments are the financial assets, securities and claims. Financial assets represent claims for the payment of a sum of money sometime in the future and/or a periodic payment in the form of interest or dividend. Financial liabilities are the counterparts of financial assets. They represent promise to pay some portion of prospective income and wealth to others.

Financial assets and liabilities arise from the basic process of financing. Some of the financial instruments are tradable/ transferable. Others are non tradable/non-transferable. Financial assets like bank deposits, insurance policies, NSCs, provident funds and pension funds are not tradable. Securities (included in financial assets) like equity shares, preference shares, debentures, bonds and government securities are tradable and hence they are transferable. In short, financial instruments are instruments through which a company raises finance.

The financial instruments may be capital market instruments, money market instruments or hybrid instruments. The financial instruments that are used for raising funds through the capital market are known as capital market instruments. These include equity shares, preference shares, warrants, debentures /bonds including innovative debt instruments. These securities have a maturity period of more than one year.

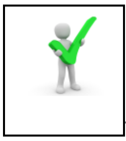
The financial instruments that are used for raising and supplying money in a short duration normally up to one year through money market are called money market instruments. Money market is basically the source of working capital to the industry. Examples of money market instruments are treasury bills, commercial paper, call money, short notice money, certificates of deposits, commercial bills, money market mutual funds.

Hybrid instruments are those instruments which have the features of both equity and debenture. Examples are convertible debentures, warrants etc. Financial instruments may also be classified as cash instruments and derivative instruments. Cash instruments are financial instruments whose value is determined directly by markets. Derivative instruments are financial instruments which derive their value from some other financial instrument or variable.

Financial instruments can also be classified into primary instruments and secondary instruments. Primary instruments are instruments that are directly issued by the ultimate investors to the ultimate savers. For example, shares and debentures directly issued to the public. Secondary instruments are issued by the financial intermediaries to the ultimate savers. For example, UTI and mutual funds issue securities in the form of units to the public.

Characteristics of Financial Instruments: The important characteristics of financial instruments may be outlined as below:

1. Liquidity: Financial instruments are highly liquid. These can be easily and quickly converted into cash.
2. Marketing: Financial instruments facilitate easy trading in the market. They have a ready market.
3. Collateral value: Financial instruments can be pledged for getting loans.
4. Transferability: The ownership of financial instruments can be easily transferred from one person to another.
5. Maturity period: The maturity duration of financial instruments may be short term; medium term or long term depends upon the nature of instruments.
6. Transaction cost: Financial instruments involve buying and selling cost. The buying and selling costs are called transaction costs.
7. Risk: Financial instruments carry risk of loss. This is because there is uncertainty with regard to payment of principal or interest or dividend as the case may be.
8. Future trading: Financial instruments facilitate future trading so as to cover risks due to price fluctuations, interest rate fluctuations etc.



Check Your Progress-A

Q1. Discuss the role of financial system in the economic development of a country.

Q2. What are the functions of financial system?

Q3. Explain the structure of Indian Financial System.

Q4. Discuss capital market instruments.

Q5. What are the hybrid instruments?

Q6. Discuss the characteristics of financial instruments.

4.7 FINANCIAL INSTITUTIONS

Financial institutions are the participants in a financial market. They are business organizations dealing in financial resources of the economy. They collect funds from individuals and institutions by accepting deposits and lend further to industries, entrepreneurs and others for the economic growth. They also deal in the buying and selling of financial instruments. They generate financial instruments as well. Financial institutions are the business organizations that act as mobilisers of savings and providers of finance. They also provide various financial services to the community. They deal in financial assets such as deposits, loans, securities and so on.

On the basis of the nature of activities, financial institutions may be classified as: (a) Regulatory and promotional institutions, (b) Banking institutions, and (c) Non-banking institutions.

1**. Regulatory and Promotional Institutions**: Financial institutions, financial markets, financial instruments and financial services are all regulated by regulators like Ministry of Finance, the Company Law Board, RBI, SEBI, IRDA, Dept. of Economic Affairs, Department of Company Affairs etc. The two major Regulatory and Promotional Institutions in India are Reserve Bank of India (RBI) and Securities Exchange Board of India (SEBI). Both RBI and SEBI administer, legislate, supervise, monitor, control and discipline the entire financial system. RBI is the supreme financial institution in India. All financial institutions are under the control of RBI. The financial markets are under the control of SEBI. Both RBI and SEBI have laid down several policies, procedures and guidelines. These policies, procedures and guidelines are changed from time to time so as to set the financial system in the right direction.

2**. Banking Institutions**: Banking institutions mobilise the savings of the people. They provide a mechanism for the smooth exchange of goods and services. They extend credit while lending money. They not only supply credit but also create credit. There are three basic categories of banking institutions. They are commercial banks, co-operative banks and developmental banks.

3. **Non-banking Institutions:** The non-banking financial institutions also mobilize financial resources directly or indirectly from the people. They lend the financial resources mobilized. They lend funds but do not create credit. Companies like LIC, GIC, UTI, Development Financial Institutions, Organisation of Pension and Provident Funds etc. fall in this category. Non-banking financial institutions can be categorized as investment companies, housing companies, leasing companies, hire purchase companies, specialized financial institutions (EXIM Bank etc.) investment institutions, state level institutions etc.

Financial institutions are financial intermediaries. They intermediate between savers and investors. They lend money and also mobilise savings. They may be further classified into two types:

(i) Capital Market Intermediaries: These intermediaries mainly provide long term funds to individuals and corporate customers. They consist of term lending institutions like financial corporations and investment institutions like Life Insurance Corporation of India (LIC).

(ii) Money Market Intermediaries: Money market intermediaries supply only short term funds to individuals and corporate customers. They consist of commercial banks, cooperative bank.

4.8 FINANCIAL MARKETS

Financial markets are another part or component of financial system. Efficient financial markets are essential for speedy economic development. Financial markets are not in itself sources of finance but they are a link between the savers and investors. In a broader term, financial market may be described as any marketplace where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. The main organized financial markets in India are the money market and the capital market. The first is the market for short term securities while the second is a market for long-term securities, i.e. securities having a maturity period of one year and more. Financial markets can also be classified as primary and secondary markets. While the primary market deals with new issues, the secondary market is meant for trading in outstanding or existing securities.

The participants in the financial markets are corporations, financial institutions, individuals and the government. These participants trade in financial products in these markets. They trade either directly or through brokers and dealers. In short, financial markets are markets that deal in financial assets and credit instruments.

Functions of Financial Markets: The main functions of financial markets are outlined as below:

1. **Borrowing & Lending**: Financial market transfers fund from one economic agent (saver/lender) to another (borrower) for the purpose of either consumption or investment.

2. **Price Determination**: Prices of the new assets as well as the existing stocks of financial assets are set in financial markets. Determination of prices is a major function of financial market.
3. **Assimilation and Co-ordination of Information:** It gathers and co-ordinates information regarding the value of financial assets and flow of funds in the economy.
4. **Liquidity:** Investors can readily sell their financial assets through the mechanism of financial markets. In the absence of financial markets which provide such liquidity, the motivation of investors to hold financial assets will be considerably diminished.
5. **Risk Sharing**: It distributes the risk associated in any transaction among several participants in an enterprise.
6. **Efficiency:** It reduces the cost of transaction and acquiring information. It helps to increase efficiency in financial market.

Classification of Financial Market:

The financial market can be classified as follows:

(a) **Unorganized Markets:** Unorganized markets consists of money lenders, indigenous bankers, traders, etc. who lend money to the general public. Indigenous bankers also collect deposits from the public. There are also private finance companies, chit funds, Nidhis etc whose activities are not controlled by the RBI. The RBI has already taken some steps to bring unorganized sector under the organized fold.

(b) **Organized Markets:** Organized markets have standardized rules and regulations governing their financial dealings. There is also a high degree of institutionalization and instrumentalization. These markets are under the strict supervision and control by the RBI or other regulatory bodies. These organized markets can be further classified into two;

(i) Capital Market and

(ii) Money Market.

4.9 CAPITAL MARKET: MEANING AND CONCEPT

Capital Market is one of the significant aspects of financial market. Hence it is necessary to study its correct meaning. Broadly speaking the capital market is a market for long term funds having long term or indefinite maturity period. It is an institutional arrangement to borrow and lend money for a longer period of time. It consists of participants like mutual funds, insurance organization, foreign institutional investors, business units, corporate and individuals. Capital market can be classified into primary/ new issue market and secondary markets/stock exchanges. Primary market deals with the new securities, that is, securities which are not previously available and offered to the investors first time. These securities are first time offered to the investors or funds are mobilized through the public issues of prospectus, private placement, right issues and preferential issues. Whereas secondary market is a market in which, existing securities are resold and bought among investors or traders usually on a stock exchange, over the counter or elsewhere. From the peripheral /marginal role in the early eighties, capital market now occupies the centre stage in the Indian financial system.

Capital market instruments

The main capital market instruments in India are given below;

Equity Shares: Equity shares are the source of long term capital of the company and it represent the real ownership of a company. The holders of the equity shares have voting rights and they participate in the important decision of the company. Features of equity shares are given below:

- Voting right for the shareholders.
- No maturity period
- Residual claim on income as well as on assets
- No fixed dividends
- Chances of getting bonus shares
- Pre-emptive rights

Preference Shares: Preference shares are shares on which the dividend is paid by the company, subject to the availability of the sufficient profits. Preference share holders are given preference over and above equity shareholders. Such preference is given at the time of income distribution and at the time of liquidation of company when assets are distributed. These have the following features;

- Fixed dividend percentage on the face value
- Preference over equity shareholders
- A fixed maturity period or provision of conversion in to the equity shares
- No voting rights
- No privilege for right and bonus shares

Generally these shares do not command the high market value because of the fixed dividend and no privilege for right and bonus shares.

Debentures: Debentures are the loan taken by the company from the general public-they carry a coupon rate called rate of interest. Interest on these is generally paid half yearly and payments of these are the legal obligation of the company. Company has to pay interest whether it earned profit or not. Debentures have the following features:

- Like preference shareholders debenture holders also don't have the voting rights.

- Payment of interest is at the fixed rate.
- Debentures can be secured or unsecured
- Debenture holders have priority over the preference shares holders and equity shareholders.
- Interest is tax deductible expense for the company.

Forward contracts: A forward contract is a customized contract/ agreement between two parties, where settlement takes place on a specific date in future at a price agreed today. Forward contracts are bilateral contracts and hence exposed to counter party risk. Each contract is custom designed and hence is unique in terms of contract size, expiration date and the asset type and quality. Forward contracts are normally traded outside the stock exchange. The contract has to be settled by delivery of the asset on expiration date. A major drawback of the forward contract is the risk of default. To minimize the risk of default, another financial instrument is introduced, the futures.

Futures: Like a forward contract, a futures contract is an agreement between two parties to buy and sell an asset at a certain time in future at a certain price. Unlike forward contracts, future contracts are normally traded on an exchange. This means that the contract is traded just like a normal stock, where the supply and demand of similar futures determine the trading price of the contract.

To make trading possible, the exchange specifies certain standardized features of the contract. As the two parties of the contract do not necessarily know each other, the exchange also provides the mechanism that gives the two parties a guarantee that the contract will be honoured.

Options: Options are contract where the holder of the instrument has the right to buy or sell the underlying asset at a predetermined price. A person who has an Option Contract need to execute the trade only if he wants to execute it. In other words he has the Option. An option can be a **call option** or **put option**. A call option gives the buyer a right to purchase an assets at a specified price on or before some specified expiration date. The specified price is called the Strike Price.

4.10 MONEY MARKET

Money market is a very important segment of a financial system. It is the market for dealing in monetary assets of short-term nature. Short-term funds up to one year and financial assets that are close substitutes for money are dealt in the money market. Money market instruments have the characteristics of liquidity (quick conversion into money), minimum transaction cost and no loss in value. Excess funds are deployed in the money market, which in turn is availed of to meet temporary shortages of cash and other obligations. Money market provides access to providers and users of short-term funds to fulfil their investments and borrowings requirements respectively at an efficient market clearing price. The money market is one of the primary mechanism through which the Central Bank influences liquidity and the general level of interest rates in an economy. The Bank's interventions to influence liquidity serve as a signalling-device for other segments of the financial system.

The money market functions as a wholesale debt market for low-risk, highly liquid, short term instruments. Funds are available in this market for periods ranging from a single day up to a year. Mostly government, banks and financial institutions dominate this market. It is a formal financial market that deals with short-term fund management.

Features of Money Market:

The money market has certain distinct operational features as compared to the capital market. First, while in the money market the operations (raising and deployment of funds) are for short duration (normally up to one year), in the capital market they are for long duration. Further money market is the institutional source of working capital to the industry, the focus of the capital market being on financing fixed investments. There are large numbers of participants in the money market: commercial banks, mutual funds, investment institutions, financial institutions and finally the Reserve bank of India. The Central bank occupies a strategic position in the money market. The money market can obtain funds from the central bank either by borrowing or through sale of securities. In addition, the money market is a wholesale market. The volumes are very large and generally transactions are settled on a daily basis. Trading in the money market is conducted over the telephone followed by written confirmation from both the borrowers and lenders.

Functions of Money Market

Money market performs the following functions:

1. Facilitating adjustment of liquidity position of commercial banks, business undertakings and other non-banking financial institutions.
2. Enabling the central bank to influence and regulate liquidity in the economy through its intervention in the market.
3. Providing a reasonable access to users of short term funds to meet their requirements quickly at reasonable costs.
4. Providing short term funds to government institutions.
5. Enabling businessmen to invest their temporary surplus funds for short period.
6. Facilitating flow of funds to the most important uses.
7. Serving as a coordinator between borrowers and lender of short term funds.
8. Helping in promoting liquidity and safety of financial assets.

Money Market Instruments

Money market is involved in buying and selling of short term instruments. It is through these instruments, the players or participants borrow and lend money in the money market. There are various instruments available in the money market. The important money market instruments are:-

1. Call and short notice money
2. Commercial bills
3. Treasury bills
4. Certificate of deposits
5. Commercial papers
6. Repurchase agreements
7. Money market mutual funds.
8. ADR/GDR

4.11 FINANCIAL SERVICES

The development of a sophisticated and matured financial system in the country, especially after the early nineties, led to the emergence of a new sector. This new sector is known as financial services sector. Its objective is to intermediate and facilitate financial transactions of individuals and institutional investors. The creators of financial services are the financial intermediaries such as banks, mutual funds, insurance companies, stock exchanges. Financial intermediaries provide the services such as merchant banking, underwriting, leasing, hire purchasing and credit rating. Financial services are very important for creation of firms, industrial expansion and economic growth.

The investors who lend money wanted assurance that it is safe to exchange securities for funds. The financial regulators who regulate the financial market and intermediaries provides this assurance. Such kind of control increases the confidence of investors, which, in turn, help in the growth and development of financial system. Regulation is not necessary to develop a system but a system once developed needs to be regulated. The RBI regulates the money market and SEBI regulates the capital market.

Check Your Progress-B

Q1. What are the financial institutions?

Q2. Describe briefly various financial intermediaries in India.

Q3.What is financial market? Briefly discuss about various types of Financial Market.

Q4. Discuss money market instruments.

Q5. What are the main financial services?

4.12 GROWTH AND DEVELOPMENT OF INDIAN FINANCIAL SYSTEM

At the time of independence in 1947, the Indian Financial System was semi-organised and there was no strong financial institutional mechanism in the country. The industrial sector was not so developed as it had no access to the savings of the community. The capital market was primitive and shy. The development of Indian Financial System started with the inception of planning in the country. After independence, the government of India adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and social objective. The government started creating new financial institutions in the public sector to supply finance both for agricultural and industrial development. It also nationalise some of the existing financial institutions so that the flow of finance might be in the right direction. The following developments took place in the Indian financial system:

1**. Nationalisation of financial institutions**: RBI, the leader of the financial system, was established as a private institution in 1935 and it was brought under government control in 1948. Next was the Imperial bank of India and its name was changed and was re-named State Bank of India. All this process was in 1956. In the same year, 245 life insurance companies were consolidated and merged and come under government control. As a result, Life Insurance Corporation of India came into existence on 1st September, 1956. Another important development has taken place in 1969 when 14 major commercial banks were nationalised. In 1980, 6 more banks were nationalized. Another landmark was the nationalisation of general insurance business and setting up of General Insurance Corporation in 1972.

2**. Establishment of Development Banks:** Another significant development of Indian financial system is the establishment of new development banks to supply institutional credit to industries. In 1949, RBI undertook a detailed study to find out the need for specialized institutions. The development bank era started in India in 1948 with the establishment of Industrial Finance Corporation of India (IFCI). In 1951, Parliament passed State Financial Corporation Act. Under this Act, State Governments could establish financial corporation's for their respective regions. The Industrial Credit and Investment Corporation of India (ICICI) were set up in 1955 and it was the pioneer for its participation in the private corporate sector. It was supported by Government of India, World Bank etc. The UTI was established in 1964 as a public sector institution to channelize the savings of the people to the productive ventures. In July 1964 The Industrial Development Bank of India (IDBI) was established as a wholly owned subsidiary of the RBI. Later the IDBI was delinked from RBI and It became an apex financial institution to provide finance and to co-ordinates the activities of all other financial institutions. In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India (IRCI) with the objective of rehabilitation of sick industrial undertakings. In 1982, the Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters and importers. On April 2, 1990 the Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund.

3**. Establishment of Institution for Agricultural Development:** The development of institutional credit for boosting rural economy was the priority for government of India from the early years of planning. So at the insistence of the government of India RBI constituted a committee to review the arrangements for the institutional credit for the agriculture and rural development. The committee was formed on 30th March 1979 and it submitted its report in 28th November 1979. The report recommended the need of new organisational institution which provide undivided attention, forceful direction and completely focused on the credit related issues linked to the rural development. On the basis of its recommendations National Bank for Agriculture and Rural Development (NABARD) was set up in 1982. The main objective of the establishment of NABARD is to extend short term, medium term and long term finance to agriculture and allied activities.

4. **Establishment of institution for housing finance:** The National Housing Bank (NHB) has been set up in July 1988 as an apex financial institution to mobilise resources for the housing sector and to promote housing finance institutions both at local and regional levels.

5. **Establishment of Stock Holding Corporation of India (SHCIL):** In 1987, India's largest custodian and depository participant institution, Stock Holding Corporation of India Ltd. was set up to strengthen the stock and capital markets. It is known for to provide quick share transfer facilities, clearing services, support services etc. to investors.

6. **Establishment of mutual funds and venture capital institutions**: Mutual funds refer to the funds raised by asset management companies by pooling the savings of the public and investing them in a diversified portfolio. They provide wide range of investment avenues for small investors who cannot participate in the equities of large cap companies. Venture capital is a long term risk capital to finance high technology projects. The IDBI venture capital fund was set up in 1986.

4.13 WEAKNESSES OF INDIAN FINANCIAL SYSTEM

Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1. **Lack of co-ordination among financial institutions:** There are a large number of financial intermediaries. Most of the financial institutions are owned by the government. At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions.

2. **Dominance of development banks in industrial finance:** The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.

3. **Inactive and erratic capital market**: In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and inactive. Investors too prefer investments in physical assets to investments in financial assets.

4. **Unhealthy financial practices:** The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse.

5. **Monopolistic market structures**: In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.

6. **Other factors:** Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system. Examples are:

a. Banks and Financial Institutions have high level of NPA.

b. Government burdened with high level of domestic debt.

c. Cooperative banks are labelled with scams.

d. Investors confidence reduced in the public sector undertaking etc.,

e. Financial illiteracy.

4.14 SUMMARY

In this unit we have read so far that financial system plays a very important role in the economic development of a country. It intermediates between the savers of funds and investors of funds. Thus, it mobilizes and usefully allocates the scarce sources of country. Financial system is a complex, well integrated set of sub- systems of financial instruments, financial institutions, financial market and financial services which allocate and transfer the funds efficiently and effectively. Financial institutions are the intermediaries. Their role is to channelize the savings into investments in an efficient manner. Financial markets are a mechanism enabling participants to deal in financial claims. Financial markets are further categorises in capital market and money market. SEBI regulates the capital market and RBI regulates money market. Financial services are those that help with borrowing and funding, lending and investing, buying and selling securities, making and enabling payments and settlements and managing risk exposure in financial markets. Whereas financial instruments are comes into existence to enable transfer of savings for investments. Financial instruments are classified as equity, debt, deposits, units, insurance policies etc. Before independence

Indian financial system was semi-organised but after independence the development of Indian financial system started with the inception of planning in the country.

4.15 GLOSSARY

Financial system: It is defined as a set of institutions, instruments and markets which promotes savings and channels them to their most efficient use.

Financial markets: Financial markets are the centres or arrangements that provide facilities for buying and selling of financial claims and services.

Intermediary: A person or firm who acts to bring together supply and demand from two other firms or persons.

Financial assets: Financial assets such as fixed deposits with banks, small saving instruments with post offices, insurance/provident/pension fund etc. or securities market related instruments like shares, bonds, debentures etc.

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4.18 TERMINAL QUESTIONS

Q1. Explain the financial structure of India. What legislative measures have strengthened its financial system?

Q2. Discuss the developments that have been taken place in the Indian financial system.

Q3. What are the characteristics and functions of Financial Market?