

Financial Management

MS109

Unit 4 Indian Financial System

MBA Second Semester

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- 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.

Functions of Financial System

- Saving function
- Liquidity function
- Payment function
- Risk function
- Information function
- Transfer function
- Reformatory function
- Other function

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

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.

Characteristics of Financial Instruments

- Liquidity
- Marketing
- Collateral value.
- Transferability
- Maturity period
- Transaction cost
- Risk
- Future trading

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

Functions of Financial Markets

- Borrowing & Lending
- Price Determination.
- Assimilation and Co-ordination of Information
- Liquidity
- Risk Sharing
- Efficiency

Classification of Financial Market

The financial market can be classified as follows:

(a) **Unorganized Markets**

(b) **Organized Markets**

These organized markets can be further classified into two;

(i) Capital Market and

(ii) Money Market

Capital Market: Meaning and Concept

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.

Capital Market Instruments

The main capital market instruments in India are given below;

- **Equity Shares**
- **Preference Shares**
- **Debentures**
- **Forward contracts**
- **Futures**
- **Options**

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.

Money Market Instruments

The important money market instruments are:-

- Call and short notice money
- Commercial bills
- Treasury bills
- Certificate of deposits
- Commercial papers
- Repurchase agreements
- Money market mutual funds.
- ADR/GDR

References:

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