Indian Financial system

In ‘Financial System” finance refers to funds or monetary resources required for the conduct of business and government activity.
It is a process of transforming accumulated savings into productive use.
Finance is a provision of money.
It is concerned with the procurement of funds.

System implies a set of interrelated elements or parts working together to achieve some purpose.
Thus, financial system consists of parts or constituents which in combination with one another form a structure for rendering an essential service of providing funds towards the attainment of goals of development and welfare.
It is a set of institutional arrangements through which financial surpluses in the economy are mobilised from surplus units and transferred to deficit spenders.
Thus,the financial system plays major role in the mobilisation and allocation of financial savings in the economy and in facilitating funds flow among the various sub sectors.
Financial institutions,instruments and together the financial markets act to transfer financial resources from savers to borrowers.

In essence, financial system is a set of complex and closely intermixed financial institutions,markets, instruments, services,practices,procedures and so on..
Financial system foster savings and channels them to their most efficient use.

Structure of Financial System
The financial system of any country consists of Financial institutions,financial markets,financial instruments and financial services which facilitate transfer of funds.

1.Financial Institutions
Financial institutions are business organisations that act as mobilizers and depositories of savings, and purveyors of credit or finance. The activities of different Financial institutions may be either specialised or they may overlap.

Banking and Non Banking Institutions

Banking Institutions
Banking institutions mobilize savings by accepting deposits from the public, participate in payments mechanism for the exchange of goods and services and extend credit by lending money.
The unique feature of the banking institutions is that they not only supply credit but also create credit. Does banks are also known as creators of credit and other financial institutionsnstitutions are mere purveyors of credit.

Non Banking Financial Institutions

Non banking Financial Institutions (NBFIs) also mobilize financial resources directly or indirectly from the public and land to the extent of resources made available. These institutions land funds but do not create credit. They are thus mere purveyors of credit. Examples of NBFIs are LIC, UTI, DFIs and Provident Funds.

Financial Intermediaries and Non- Intermediaries:
Financial Institutions are also classified as intermediaries and non intermediaries.

Financial Intermediaries:
Financial intermediaries are institutions that mediate between ultimate lenders and ultimate borrowers or between the savers and investors or between those with budget surpluses and the deficit spenders who borrow funds for investment purposes.
The banking institutions are intermediaries as they act as bridges between the people by mobilizing their savings as monetary deposits in terms of financial claims against themselves and the real sector production units who borrow funds for investment.
In addition to the banks non banking institutions like LIC,GIC, UTI ,PFs are also financial intermediaries as they channelize funds from the savers under their schemes and take up lending for investment. There are known as Non Banking Financial Intermediaries (NBFIs).

Non- Intermediaries:
Non- intermediary Institutions also do the loan business but their resources are not directly obtained from the savers.
The Development Financial Institutions (DFIs) like IDBI, IFCI,NABARD are non-intermediaries and non- banking institutions.
DFIshave came into existence because of governmental efforts to provide assistance for specific purposes sectors and regions.

2. Financial Markets:
Financial markets are the centres for arrangements that provide facilities for buying and selling of financial claims and services.
Financial assets represent some claim to the payment of a sum of money sometime in the future and for periodic payment in the form of interest or dividend.

Classification of Financial Markets
Functionally financial markets are broadly subdivided under two heads money market and capital market.
Money market deals in the short-term claims (with a period of maturity of one year or less).
Capital market deals in the long-term claims (maturity period above 1 year).

Capital market can be further classified into Primary market and Secondary market.

Primary market deals in the new financial claims or new securities and therefore also known as new issue market.

Secondary market deals in securities already issued or existing or outstanding.

The primary market mobilise savings and supply fresh or additional capital to business units.
Although secondary markets do not contribute directly to the supply of additional capital they do so indirectly via landing securities issued on the primary markets liquid.

3. Financial Instruments or Securities
Financial instruments refer to those documents which represent financial claims on assets. Bills of exchange, Promissory note, Treasury bills, Government bond, Share ,Debentures are examples of financial instruments.
financial securities can be classified on the basis of nature of issue and on the basis of duration.
(I) On the Basis of Nature of Issue financial securities are classified as primary and secondary securities.
(II) On the basis of duration financial securities may be classified under three heads

(a)Short term securities-up to 1 year
(b) Medium term securities-1to 5 years
(c) long term securities-more than 5 years.

4. Financial Services
The activity which facilitates exchange of resources available at different points of time can be recognised as financial service.
Financial services fulfill the needs of Financial Institutions ,financial Markets ,and financial instruments.
The important financial services are merchant banking, leasing, credit-rating,underwriting etc.
Thus a financial system comprises financial Institutions, markets, instruments and services which provide the essential framework for the mobilization and allocation of savings. The primary role of any financial system is to act as a conduct for the transfer of financial resources from savers to borrowers.

Functions of Financial Systemq.push(s.append("0"));

1.Inducement to Save
2.Mobilisation of savings
3.Allocation of Funds

Significance of Financial System
Finance is the provision of money.
It is exclusively concerned with the procurement of funds.
It is concerned with money and everything that takes place for smooth functioning of a business concern.
The financial system performs an important role in economic development on.

The wealth of a nation can only be constructed through a well developed financial system.The financial system directly helps to increase the savings by offof a country through saving- investment process, also known as capital formatiering better returns to the savers.
The system will convert the savers, into investors successfully.
It also make efficient allocation of resources in different investment channels.
The Financial Institutions channel the funds of surplus economic units to those wanting to spend on real capital investment.Funds are transferred through the creation of financial liabilities such as bonds and equity shares.
financial intermediation can enhance growth by pulling funds of the small and scattered savers and allocating them for investment in an efficient manner.
Financial Institutions promote development by offering four transformation services:

1. Liability- Asset transformation
Financial Institutions issue claims (viz.deposits)to the customers that have characteristics different from those of their own assets, which inturn,meet the requirements of a different set of their customers(viz.corporates).

2. Size- transformation
Financial Institutions collect small and scattered deposits from public and provide large loans.

3. Risk - Asset transformation
Financial Institutions provide risk transformation by transforming and reducing the risk involved in direct lending by requiring more diversified portfolios than individual savers can.

4. Maturity transformation
Financial Institutions borrow short and ,on an average, lend long and in the process, they change the length of debt.

In a nutshell,the financial system facilitated allocation of resources. This helps in the maximum utilisation of savings.it also facilitates no of savings through out the economy and thereby the flow of funds and directions where returns are highest.

Composition of the Indian financial system

Indian financial system comprises of two parts:
1. The Indian money market
2. The Indian capital market

Indian money market
Money market is the market that deals in short term funds i.e. infants with maturity period of upto 1 year.

It is a highly liquid market.It performs the following functions:
1. It provides and equilibrating mechanism to even out demand for and supply of short term funds.
2.It provides a focal point for the central bank for its intervention in the markets for the purpose of influencing liquidity.
3.It provides access to providers and users of short term funds to fulfill their borrowing and investment requirements.

Structurally, the Indian money market is divisible under two sectors : organised and unorganised.

The organised sector
The organised money market comprises Reserve Bank of India , commercial banks, cooperative banks Land development banks.Non Banking Financial Institutions such as the LIC,GIC, UTI also operate in this market but only indirectly.
It is called organised because its parts are systematically coordinated and controlled by the RBI.
Traditionally it dealt in Treasury Bills,Call money and to some extent Commercial Bills.
The Indian money market in essence is a short-term credit market. It is not one market but collection of different sub markets.
The main components of the Indian money market are call money market, collateral loan market, acceptance market ,bill market, commercial paper market, money market mutual funds etc.

The unorganised sector
The unorganised money market contains agencies which have diverse policies, lack of uniformity and consistency in the lending business.
This market is largely made up of indigenous bankers and moneylenders. They are also known as seth,shroffs, sahukars and multans.
This sector is unorganised because the activities of its parts are not systematically coordinated by the RBI or any other authority.
the indigenous bankers and moneylenders are still major source of short-term loans for the small borrower.

The Indian capital market
Indian capital market deals in medium and long term funds.
It refers to all the facilities and institutional arrangements for borrowing and lending term funds (maturity period above 1 year).
The demand for long term money capital comes from private and public sector manufacturing industries, trading and transport units and agriculture too.
The central and state governments raise substantial amounts from the capital market.

The purpose of capital market is to
1.Mobilize long-term savings to finance long-term investments;
2.Provide risk-capital in the form of equity to entrepreneurs;

3.Encourage broader ownership of productive assets;
4.Provide liquidity with a mechanism enabling the investor to sell financial assets;
5.Improve the efficiency of capital allocation through a competitive pricing mechanism.
Capital market also is divisible into organised and unorganised sector.

The Organised Sector
The organised sector of capital market comprises the stock market,comercial banks,insurance companies and corporate savers.
Organised Indian capital market may be classified into :
(i) Gilt-edged market or Government Securities market
(ii) Industrial Securities Market
(iii) Development Financial Institutions
(iv)Financial Intermediaries.

Gilt-edged Market refers to the market for government and semi government securities.

Industrial Securities Market is the market for equities and debentures of companies of corporate sector.
This market is further classified into : New Issue Market and Old Issue Market

Unorganised Sector
The unorganised sector of Indian Capital Market is mainly made up of indigenous bankers,money - lenders,chit-funds and other similar financial institutions.
The role of unorganised sector is of very limited importance.

The Reserve Bank of India

The RBI commenced operations from 1st April,1935.
Originally, it was constituted as a shareholder"s bank.
The bank"s fully paid-up share capital was Rs.5 crores divided into shares of Rs.100 each.
The bank was nationalised on 1st January,1949.

Organisational Structure and Management of the RBI

On 1st January,1949 the RBI started functioning as a state-owned central banking institution.
The bank is managed by a Central Board of Directors, Four Local Boards of Directors, and a committee of the Central Board of Directors.
The functions of the Local Boards are to advise the Central Board on matters referred to them;they are also required to perform duties as are delegated to them.

Organisational Structure of RBI

Reserve Bank of India
|

| |
Central Board of Directors **Local Boards**
|
Governor
|
Deputy Governor
|
Executive Director
|--|
Central Office Departments **Training Establishments**

Central Board

The Central Board of Directors consists of 20 members as follows:

1.One Governor and Four Deputy Governors appointed by the Central Government.
They are whole time officers of the bank.
Their term of office does not exceed 5 years.

2.Four Directors nominated by the Central Government one from each Local Board.
Their term of office is related to their membership of the Local Boards.

3.Ten Directors nominated by the Central Government.
They are experts from the fields of business,industry,finance and co-operation.
They hold office for 4 years.

4.One Government Official (the Seceratry, Ministry of Finance is usually nominated by the Central Government.)

Central Board of Directors **(20 Members)**
|
Governor (1)
|

| |
Deputy Governors(4) **Directors (15)**
|
|

	Nominated by Central Government (10) Experts of Different Fields	Nominated by Local Boards (4)	Government Officia(1) (Secretary Ministry of Finance)

Local Boards

The RBI is divided into four regions :

The Western	**Mumbai**
The Eastern	**Kolkata**
The Northern	**New-Delhi**
The Southern	**Chennai**

There are 5 members in each local board. In each local board, a chairman is elected from the members.

To carry out its functions efficiently, the RBI has 23 Departments.
RBI has also 3 Training Establishments for imparting training in different areas of banking.

1.Banker"s Training College,Mumbai
2.College of Agricultural Banking,Pune and
3.Reserve Bank Staff College,Chennai.

Objectives of the RBI

The main objectives of the RBI are;

1.To regulate the issue of Bank notes;

2..To organise a sound and healthy system of commercial banking in the country;

3.To act as a banker to the commercial banks and to some of the financial institutions,holding custody of their cash reserves and granting them accommodation;

4.To regulate the supply of credit by using the instruments of general and selective credit controls;

5.To conduct the banking and financial operations of the Government;

6.To maintain exchange value of rupee;

7.To manage the country's international reserves and to exercise control over payments and receipts

8.To perform developmental and promotional functions relating to (a) the extension of the banking system,(b) establishment or promotion of new specialised financing agencies,
(c) expansion of facilities for the provision of agricultural credit,(d) widening the facilities for provision of industrial finance,and (e) the systematic development of the under developed Indian money market; and

9.To collect and publish data relating to money,credit,banking and foreign exchange in India.

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                              Functions of RBI

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                                     |
   ------------------------------------------------------------------------------------
   |                                  |                                          |
Central                          Promotional
Supervisory
Banking                            and                                      Functions
Functions                      Developmental
  |                              Functions                                       |
  |                                  |
Note Issuing                   Promotion of                               Licensing of
Authority                      Commercial Banks                              Banks
  |                                  |                                         |
Banker to                      Promotion of Rural                           Branch
Government                           and                                  Licensing
  |                            Agricultural Credit                          Policy
Banker's Bank                          |                                        |
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And **Promotion of** **Approval**
of
Lender of the **Industrial Finance** **Capital**
Reserves
Last Resort **|**
Credit Control **Inspection of**
| **Banks**
Regulation of **|**
Foreign Exchange **Control**
over
|
Management
Collection of Data **of Banks**
And Publications **|**
Audit of
Banks
|
Training
And
Banking
Education

Monetary Policy

Monetary Policy refers to the Central bank's policy pertaining to the control of the availability,cost and use of money and credit with the help of monetary measures in order to achieve specific goals.

Objectives of Monetary Policy

The objectives of monetary policy are :
1. **Neutrality of Money;**
2. **Exchange rate stability and equilibrium in the balance of payments;**
3. **Price stability and control of business cycles;**
4. **Full employment:; and**
5. **Economic growth.**

Monetary Policy of RBI

In developing country like India, the monetary policy cannot remain confined only upto controlling the supply of money as in the case of the developed countries.
In India,it has been structured to meet the particular development requirements of the planned economy.
in a growing economic there has to be continuous expansion of money supply and credit to meet the credit requirements of different potential sectors of the economy

such as industry agriculture exports and so on. At the same time the rate of inflation has to be contained within reasonable limits.

RBI tries to regulate the money supply by controlling bank credit.Variations in the bank credit is the major factor which influences economic activity in India. It tries to influence the cost volume and the direction of credit in the economy and pay special attention to seasonal requirements of credit.

Instruments of monetary policy

Instruments or methods of credit control may be classified into quantitative and qualitative methods.

Quantitative methods also known as general methods of credit control.
These methods are used for increasing or decreasing the volume of credit.
Important quantitative methods are bank rate,open market operations and variable reserve ratios.

1.Bank Rate
The bank rate is the rate of interest at which the RBI makes advances to the commercial banks against approved securities or rediscounts the eligible bills of exchange and other commercial papers.
Change in the bank rate leads to changes in the market rates of interest.
If bank rate is raised rates of interest in the money market including the lending rates of commercial banks also rise. So the cost of credit rises.the demand for bank loans generally falls and show the demand for goods will also fall.Does inflation can be checked by raising bank rate.
Similarly definition can be checked by lowering the bank rate.
Present bank rate is 4.65 %

2 Open market operations
Open market operations means sale or purchase of government securities by the central bank in the money market.
Inflationary situations Central Bank will sale securities. Buyers of these bills are commercial banks or the others make payments to the central bank.transfer of funds from commercial banks to Central Bank will reduce cash reserves of commercial banks.
in terms of depression the central bank will buy securities in the market in this way money will be transferred from Central Bank to commercial banks.
an increase in funds of commercial banks will expand level of investment production and employment.

3. Variable reserve ratios
The commercial banks are required to keep a certain amount of cash reserves.
By increasing or decreasing this reserve the RBI can influence supply of money or credit creating capacity of commercial banks

Commercial banks are required to maintain two types of reservation:
(I) Cash Reserve Ratio(CRR,)
(II) Statutory Liquidity Ratio (SLR)

CRR refers Udaipur station of total deposits of a commercial bank which it has to keep with the central bank in the form of cash.Present CRR is 3 percent

SLR refers to that portion of total deposits of a commercial bank which it is required to keep with itself in the form of liquid assets. Present SLRis 18 percent
When the above ratios are raised, it leads to a reduction in the lending capacity of banks which in turn lend out at a higher rate of interest than before.
on the other hand reduction in these ratios causes expansion of credit by banks.Which results in an increase of investment production employment income and prices.

Qualitative or selective credit control methods:
1. Rationing of credit
2. Changes in margin requirements
3.Regulation of consumer credit
4. Direct action.
5.Moral Suasion

General versus selective credit controls

Assignment - 1
Attempt any two questions
Q.1 Explain meaning, functions and significance of financial system.

Q.2 Explain functional classification of Indian financial system.

Q.3 what is monetary policy? Briefly discuss various methods used for monetary control in India.

Commercial banks

A bank is an institution that accept deposits of money from the public withdrawable by cheque and used for lending.
It is a profit seeking business firm dealing in money and credit.
Commercial banks are creators of credit.
Thus acceptance of chequable deposits of the public and creation of credit are unique features of commercial banks.

Functions of Commercial Banks

Primary functions
1.Acceptance of deposits
2. Advancing loans
3. Use of the cheque system
4. Remittance of funds

Secondary functions
1.Agency services
2. General utility services

Investment policy of Banks
1. Principle of safety
2. Principle of liquidity
3. Principle of productivity of Investment
4. Principle of diversity
5. Principal of tax exemption of Investments.
Bank create credit in two ways
I) By advancing loans
II) By purchasing Securities

Commercial banks in India classified in various categories according to different criteria

on the basis of ownership banks may be classified into public sector commercial banks and private sector commercial banks

Public sector banks major types of banks in India year a majority steak more than 50% is held by the government
Number of public sector bank has been reduced to 12 from 27
at present there are 22 private sector commercial banks in India
Effective from 1st April 2020

Classification of commercial bank on the statutory basis
Scheduled commercial banks and non scheduled commercial banks
Scheduled banks are those banks which have been included in the second schedule of the RBI
Average scheduled bank enjoys following facilities
1.search for banks becomes eligible for obtaining dates for loans on bank rate from Reserve Bank of India
2. Search Bank automatically acquire the membership of clearing house
3. Search banks also get the facility of rediscount of first class exchange bills from RBI
Non scheduled banks are not entitled
to borrow from the RBI for normal banking purpose they may approach for accommodation under abnormal circumstances.

Recent trends in Indian commercial banks
1. Fast growth of Bank branches
2. Branch opening in an bank and rural areas
3. Transformation of class banking into mass banking
4. Lending to priority sector
6. Merchant banking and underwriting
7. Retail banking
8. Mutual funds
9. Banks entry into insurance business
10. Stock investment
11. Virtual banking.

Development Banks
Development Banks are specialised Financial Institutions.
They do not accept deposits from the public.
They specialised in providing medium and long term finance.
Their chief distinguishing
role is the promotion of economic development or promoting investment and enterprise in their allotted spheres whether manufacturing , agriculture or some other.

Features of a development Bank
1. It is a specialised financial institution.
2.It provides medium and long term finance to business unit
3.It does not accept deposits from public.
In other words development Banks are non intermediary institutions.
4.It is a multi purpose financial institution
5.It is a development oriented bank.
6. It's motive to serve public interest rather than to make profits.
7. Development Banks come into existence because of governmental efforts to provide assistance for specific purposes , sectors and regions.

Objectives of Development Banks
1.to serve as an agent development in various sectors like industry agriculture and international trade

2. to accelerate the growth of the economy.

3. to alocate resources to high priority areas

4. to foster rapid industrialisation particularly in the private sector.

5. to develop entrepreneurial skills

6. to promote the development of rural areas

7. to finance housing, small scale industries infrastructure and social utilities.

Functions of development Banks
1.Promoting investment of public and private capital for development.
2.Providing technical assistance to help prepare , finance and carry out development projects and programmes.
3. Cooperating with governments, Reserve Bank of India and Development Banks and other organisations that are concerned with the investment of development of funds.
4.Promoting institutional infrastructure to accelerate the process of economic development.
5. Train entrepreneurs and professional managers.
6.Undertaking other activities in providing other services as necessary to foster growth.

Development Banks in India
Development Banks in India may be classified into three groups:
Industrial Development Banks,
All India level Development Banks
IFCI
IDBI
IRBI
ICICI
SIDBI
State Level
SFCs
SIDCs

Agriculture Development banks
All India level
NABARD
State Level
SLDBs
Export Import Development Bank.
EXIM

Industrial Development Banks
Industrial finance corporation of India (IFCI)
IFCI was the first Development bank established India in the year 1948.
Objectives of the IFCI
objectives of IFCI are integrated with the objective of the five year plans and the broad National policies framed by the government from time to time.It AIMS at providing financial assistance to large-scale industrial concerns and less developed areas of the country.
It gives particular attention to the following categories of projects:
1. Promoted by new entrepreneurs
2. Based on indigenous technology

3. Which would result in substitution of imports

Functions of the IFCI

1.India's loans and advances to industrial concerns and subscribe to the debentures floated by them.

2. It guarantees loans raised by the industrial concerns.

3. It underwrites shares and debentures of the industrial concerns.

4.It guarantees deferred payments in respect of import of machinery, foreign currency loans raised from foreign Institutions and loans raised from scheduled banks for state cooperative banks by industrial concerns.

IFCI caters to the financial needs of large and medium sized limited companies in the public and private sectors and co-operative societies engaged in the manufacture, preservation, processing,shipping mining for hotel industry are in generation and distribution of electricity or any other form of power.

Industrial Development Bank of India

IDBI was established in 1964 with the objectives of meeting the growing financial needs of rapid industrialisation and for coordinating the activities of all agencies which are concerned with the provision of finance for industrial development.

Functions of the IDBI

The main functions of IDBI are as follows:

1. Direct finance

IDBI has been providing direct financial assistance to large industrial concerns and medium industrial concerns.

The IDBI grants direct finance by way of project loans,underwriting of and direct subscription to industrial securities.

2.Indirect Finance

IDBI financial those banks and Financial Institutions which are lending to industrial concerns. It has subscribed to the stocks shares bonds and debentures of IFCI state financial corporations and other notified Financial Institutions so as to increase their financial resources and enable them to provide larger assistance to industry.

3. Special Assistance

The industrial Development Bank of India act 1964 has provided for the creation of special fund known as the development assistance fund. This fund is used to assist those industrial concerns which are not able to secure finances in the normal course because of low rate of return.

4. Foreign currency requirements

IDBI raises foreign funds from international money markets and international funding organisations and makes them available to Indian industrial units.

5. Assistance to backward areas

IDBI especially entrusted with the task of promoting industrial development in the backward areas.

6. Assistance to small scale sector
IDBI extends assistance to small scale industries and small road transport operators indirectly through state level institutions and commercial banks by way of refinance of industrial loans.

Industrial credit and investment corporation of India ICICI
ICICI established in 1955.sponsored by a mission from the world Bank in order to develop small and medium industries in the private sector.

Objectives of the ICICI
ICICI has been established for the purpose of assisting industrial enterprises within the private sector in India by:
1. Assisting in the creation expansion and modernization of such enterprises;
2.Encouraging and promoting the participation of private capital in such enterprises;
3.Encouraging and promoting private ownership of industrial investments and the expansion of investment markets.

Functions of the ICICI
1. It grants long term or medium term loans both rupee loans and foreign currency loans.
2. It participates in equity capital and in debentures issues of companies.
3. It underwrites new issues of shares and debentures.
4. it guarantees loans from other private investment sources.
5. It provides financial services such as deferred credit least credit instalment sale asset credit and venture capital.

Small Industries Development Bank of India (SIDBI)

Small Industries Development Bank of India was established as wholly owned subsidiary of IDBI under the Small Industries Development Bank of India act 1989 as the principal financial institution for promotion, financing and development of industries in the small scale sector.
SIDBI started its operations from 2nd April ,1990.
It's head- quarter is situated at Lucknow.
SIDBI also coordinates the activities of agencies which provide finances to small enterprises.

Objectives of the SIDBI
1.To initiate steps for technological upgradation and modernisation of existing units;
2. To expand channels for marketing of SSI sector products
3.To promote employment oriented industries in semi urban areas.

Functions of SIDBI
1. SIDBI refinance loans and advances extended by the primary lending institutions to small scale industrial units and also provides resources support to them.

2.SIDBI discounts and rediscounts bills arising from sale of machinery to or manufactured by industrial units.
3. SIDBI extends seeds capital/ soft loan assistance under National equity fund ,Mahila Udyam Nidhi and Mahila Vikas Nidhi and Seed Capital Schemes through specified lending agencies.
4. SIDBI grants assistance as well as early finance loans extended by primary lending institutions for financing export of products manufactured by industrial concerns in the small scale sector.
5. SIDBI provide services like leasing and factoring to industrial concerns in the small-scale sector.

National Bank for Agriculture and Rural Development (NABARD)

NABARD is the apex financial institution providing finance for agriculture and rural development. It was established on 12th July 1982, with the paid up capital of rupees 100 crores.

Functions of the NABARD
1.NABARD services as a refinance institution for all kinds of production and investment credit to agriculture, small scale industries, cottage and village Industries, handicrafts and rural crafts and other allied economic activities with a view to promoting integrated rural development.

2.It provide short term, medium term and long term credits to state cooperative banks ,land Development Banks and other Financial Institutions approved by RBI.

3.It gives long term loans to any institution approved by the Central Government or contribute to share capital or investment in securities of any Institution concerned with agriculture and rural development.

4.It gives long term loans up to 20 years district government enable them to subscribe to the share capital of cooperative credit societies.

5. it has responsibility of coordinating the activities of Central and state governments , planning commission and other all India and state level institutions.

6. It has the responsibility to inspect RRBs and cooperative banks.

7.It maintains research and development fund to promote research in agriculture and rural development, to formulate and design projects and programmes to suit the requirements of different areas and to cover special activities.

Export Import Bank of India
Exim Bank was set up on 1st January 1982 to take over the operations of the international finance wing of the IDBI and to provide financial assistance exporters and importers and function as the principal financial institution for coordinating the

working of other Institutions engaged in financing of exports and imports of goods and services.
the Exim Bank provides refinance facilities to the commercial banks and Financial Institutions against their export-import financing activities it is an apex institution which promotes foreign trade its head office is situated at Mumbai.
Functions of Exim Bank
1.financing of exports and imports of goods and services
2.financing of exports and imports of machinery and equipment on lease basis
3. Financing of joint ventures in foreign countries
4.providing loans to Indian parties to enable them to contribute to the share capital of joint ventures in foreign countries
5. Undertake limited merchant banking functions such as underwriting of stocks and shares bonds or debentures of companies engaged in export or import
6. Provide technical, administrative and financial assistance to parties in connection with export or import
7. Providing refinance facilities to commercial banks by discounting their export bills.

State level Development Banks
The state financial corporation act was passed in 1951, which authority is state to establish an SFC.
The first sfc was established in Punjab in 1953.
At present there are 18 SFCs in the country.

Objectives of SFCs

The principal objective of the SFCs to provide medium and long-term financial assistance to small industrial enterprises.
sfcs have been established to help entrepreneurs to set-up new industries and undertake programs of modernization renovation expansion and diversification.

Functions of SFCs

1. Granting loans or advances for subscribing to debentures of industrial concerns repayable within 20 years.
2. Guaranteeing loans raised in the market or from scheduled banks for cooperative banks by the industrial concerns and re table within 20 years;
3.guarantee of deferred payments of any industrial concern as in connection with the purchase of capital goods within India;
4.underwriting issue of stocks bonds or debentures of industrial concerns subject to their being disposed of in the market within 7 years;
5. Providing foreign exchange loans under world Bank scheme;
6.participating in equity capital of small scale industrial units coming up in backward areas.

Indian financial system

Second assignment
Attempt any two questions
Q.1 Define bank and describe the main functions of Commercial Bank.
Q.2 Describe the structure of commercial banks in India and give an account of the recent trends of commercial banking in India.
Q.3 What do you understand by Development Bank? How does it differ from a commercial bank?

Financial Markets

Financial markets are the centres or arrangements dating buying and selling of financial claims, assets, services and securities.
Financial markets are the channels through which funds flow from one market participant to another
Financial markets are the credit markets.
They cater to the various credit needs of the individuals forms and institutions.
Financial markets facilitate transfer of funds from surplus sector (lender)to deficit sector (borrowers).

Functions of Financial Market
1. To facilitate creation and allocation of credit and liquidity.
2.to serve as intermediaries in the process of mobilization of savings in the economy.
3.to provide financial convenience to the people or to facilitate transfer of funds from lender to borrower.
4.to assist the process of economic development through a more balanced regional distribution of investible funds.

Structure of Financial Markets

Functionally financial markets are sub divided under two heads money markets and capital markets.
Money market deals in short term funds.
Capital market deals in long term funds.

Money market is divisible under two sectors as organised and unorganised.

Organised Money Market comprises the RBI and commercial banks.
It is called organised because its parts are systematically coordinated by the RBI.
non banking Financial Institutions such as LIC and UTI also operate in this market.
The unorganised money market is largely made up of of indigenous bankers and moneylenders.it is an organised because the activities of its parts are not systematically coordinated by the RBI or any other authority.

The capital market deals in medium term and long term funds it is also divisible into two sectors organised and unorganised.

The organised sector comprises the stock market, the RBI, commercial banks, Development Banks, LIC ,GIC and UTI.
uorganised sector is mainly made up of indigenous bankers and moneylenders nidhis and similar other Financial Institutions finance companies and hire purchase companies.
role of unorganised sector in the capital market is a very limited importance.
Money market refers to the institutional arrangements facilitating borrowing and lending for short term funds.
It is a market for short term securities one year or less in original maturity.
it deals with real money like treasury bills bankers acceptances and commercial papers.

Money market is not a particular place like the stock market but an activity and all the trading is done through telephones, telegraph or other means of communication.
It includes all individuals commercial banks Financial Institutions mutual funds and business firms dealing with short term funds.
No personal contact or presence of the two parties essential for negotiations in money market.

Characteristics of Money Market
1. It involves an arrangement of short term funds.
2.it is collection of various sub markets such as call money market ,treasury Bill market ,commercial bill market,commercial paper market and certificate of deposits market.
3. It refers to lending and borrowing activities of Banking, Financial Institutions and individuals.
4.It is a wholesale market of short term debt instruments.
5.online stock market trading is conducted on the exchange trading in the money market is conducted through means of communication followed by written confirmation from both the borrower and lender.
6. Transactions have to be conducted without the help of brokers.

Importance of money market
1.Money market provides investment outlets to commercial banks, NBFIs, business corporations and other investors for their short term funds.
2.It provides short points to businessman industrialist and traders to meet their day to day requirements of working capital.
3.it enables businessman with temporary surplus funds to invest them for a short period.
4.It enables the government to obtain short term accommodations by means of treasury bills without interfering with the normal functioning of the banking and credit system in the economy.
5. The money market search as a medium through which the central bank of the country exercises control on the creation of credit.

6. Money market offers and revenue to the commercial banks for investing short term surpluses of funds and borrowing for short term needs so as to meet statutory requirements of CRR and SLR.
7.Money market service as an important guide to the government in formulating, revising and implementing its monetary policy.
8.Money market offers to the government and important non inflationary revenue of raising short term funds through bills which are subscribed by commercial bank and the public.

Money market instruments and components
1. Call Money Market
Call money market refers to the market for extremely short period loans 1 day to 14 days.
This market is also known money at call and short notice.Call money market in India refers mostly to the inter bank call money market.the surplus banks in this market lend to the needy banks.

2. Collateral Loan Market
When loans are offered against securities like stocks and bonds they are called "collateral loans" and the market is known as the collateral loan market.
These loans are given for a short period for a few months.

3.Acceptance Money Market
A banker's acceptance is a draft drawn by an individual or firm upon a bank ordering it to pay the order of a designated party or bearer a certain sum of money at a particular future date and this draft is accepted by the bank.Bankers acceptances can be easily sold or discounted in the money market called the "acceptance market."
Bankers acceptances are used mainly in financing the movement of goods in international trade.

4. Bill Market
The financial instrument which is traded in the Bill market is a bill of exchange.
It is used for financing a transaction in goods that takes some time to complete.
Bills of exchange discounted by commercial bank to lend credit to the bill holder or to borrow from the central bank.
Treasury bill is a particular kind of finance bill put out by the government of the country.
This Bills of exchange are commercial papers on the other and treasury bills are government papers. Treasury bills are short term government security usually of 91 days duration sold by the central bank on behalf of the government.

5. Commercial paper market
Commercial papers are short term unsecured promissory notes with fixed maturity is issued mostly by the leading nationally reported and highly rated large corporations.

6. Certificates of Deposits Market

Certificate of deposits are Bank deposit account which are transferable from one party to another they are market table or negotiable short-term instruments in bearer form and are known as negotiable certificate of deposits also.

Institutions of Money Market
1. The central bank
2. Commercial banks
3. Non banking financial intermediaries
4. Acceptance houses
5. Discount houses, Bill Brokers and Dealers

Indian money market
The principal components of the organised sector of Indian money market are:
The Call Money Market, The Treasury Bill market, The Commercial Bill Market, The Certificates of Deposit Market , Commercial Paper Market , Money Market Mutual Funds and the Repo Market.

Call money market
Call money market is the most sensitive part of the financial system.the loans made in this market are of a short-term in nature there maturity wearing between one day to a fortnight.Call money market is also known as interbank call money market.Banks borrow from other banks in order to meet a sudden demand for funds, large payments, large remittances and to maintain cash or liquidity with the RBI.

Treasury Bill market
Treasury bill is a particular kind of a promissory note put out by the government of the country. Treasury bills are highly liquid. Treasury bills are issued at a discount by the RBI on behalf of the central government as its agent.

Commercial Bill Market
Commercial bill is a bill drawn by one merchant firm on the other. In India the commercial bill market is highly undeveloped. The purpose of a commercial bill is to reimburse the seller if the buyer delays payment.

Certificate of deposit market
Certificate of deposits are Bank deposit accounts which are transferable from one party to another.It is a certificate issued by a bank to depositors of funds that remain on deposit at the bank for a specified period. Thus CDs aresimilar to the traditional term deposits but are negotiable and tradable in the short term money markets.

The commercial paper market
the commercial paper is a short-term instrument of raising funds by corporates.It is essentially a sort of unsecured promissory note sold by the issued to a Banker or a security house.

Money Market Mutual Funds

Money market mutual funds was introduced by the RBI in April 1992.Money Market Mutual Funds is a fund which mobilizes funds from the general public.
The resources will be deployed in money market instruments such as call /notice money, treasury bills, certificate of deposits ,commercial paper and government securities having an unexpired maturity upto 1 year.

The Repo market
Repo is a money market instrument which helps in short term borrowings and lending.
A repo or reverse repo is a transaction in which two parties agree to sell and repurchase the same security.Under such a contract the seller sells specified securities with an agreement to repurchase the same at a mutually decided to future date and price.

Recent trends and Reform Measures in Indian money market
1.integration of unorganised sector with the organised sector
2. Widening of call money market
3. Introduction of new money market instruments
4. Promotion of Bill culture
5. Introducing Money Market Mutual funds
6. Establishment of the discount and finance house of India
7.Sector specific refinance facilities.

Capital Market

Capital market is the market for long term funds both equity and debt.
It is concerned with the raising of money capital for purposes of investment.
It deals with shares ,stocks, debentures and bonds.
It provides market mechanism for those who have savings and those who need funds for productive uses.
It diverse resources from unproductive channels to productive Investments.
The demand for long term capital comes from private sector industries and from the government largely for the purpose of economic development.
The supply of funds for the capital market comes from individual savers, corporate savings, banks, insurance companies specialised financing agencies and the government.
There are specialised Financial Institutions such as Development Banks, which also supply capital funds to industries.

Composition of the capital market in India
The Indian capital market can be divided into two parts:
The Financial Institutions and
The securities market

1. The Financial Institutions

Development Financial Institutions like IFCI, IDBI, ICICI provide medium and long term loans payable on easy installments to big business houses.
such Institutions help in promoting new companies, expansion and development of existing companies and meeting the financial requirements of companies during economic depression.

2. The securities market
Securities market market is broadly divided into gilt- edged market and industrial securities market.

The gilt-edged market, is also known as the government securities market the securities traded in this market are stable in value.
Since the government cannot default on its payment obligations the government securities are risk free and hence are known as gilt edged which means of best quality.
Important features of the government securities market are as follows:
1.it is a risk free market and returns are guaranteed.
2. The investors in government securities predominantly Institutions which are often compelled by law to invest a certain portion of their funds in these securities.
The commercial banks, the LIC the GIC and provident funds come under this category.
3.The transactions in the government securities market are very large and each transaction may run into several crores of rupees.
4. The government securities market is an over the counter market.
5. Government securities of the most liquid debt instruments.

Industrial securities market
Industrial securities market refers to the market for shares and debentures.
the principal instruments are equity shares preference shares debentures and bonds.
This market is further divided into the new issue market and the old issue market.

The new issue market
new shoe market or primary market is that part of the capital market which is concerned with the issue of new securities.public limited companies often raise funds through the primary market for setting up or expanding their business.In other words the new issue market deals with the new securities which were not previously available to the investing public or the securities that are offered to the investing public for the first time.
Functions of new issue market
the main functions of new issue market is to facilitate transfer of resources from savers to the users. The savers are individuals commercial banks and insurance companies. Users are public limited company and the government.the new issue market place and important role of mobilizing the funds from the savers and transfer them to borrowers for production purposes.
this function of new issue market can be divided into triple service functions Origination, Underwriting and Distribution.

1. Origination:origination refers to the work of investigation, analysis and processing of new project proposals. Origination starts before and issue is actually floated in the market. There are two aspects in this function:
(I) A careful study of the technical, economic and financial viability to ensure soundness of the project.This is a preliminary investigation undertaken by the sponsors of the issue.
(II) The advisory services:
Type of issue, magnitude of issue , Time of floating an issue ,pricing of an issue,methods of issue, technique of selling the securities.
2.Underwriting : Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares and debentures or a specified amount of a stock in the event of public not subscribing to the issue.
If a part of share issues remain unsold the underwriter will buy that unsold part of share issue. Thus underwriting is a guarantee for the marketability of shares.
3. Distribution: Distribution is the function of sale of securities to ultimate investors. this services performed by brokers and agents who maintain regular and direct contact with the ultimate investors.

Methods of Floating New Issues
1.By Public issue or Prospectus
2. By Offer for Sale
3.By Placement
4.By Offering Rights Issue

Public issues
Under this method the issuing company directly offeres to the general public a fixed number of shares at a a stated price through a document called prospectus.
The prospectus is an invitation to the general public for subscribing to the capital.
It contains following details regarding particulars of the company:
1. Name of company.
2. Address of the registered office of the company.
3. Existing and proposed activities
4. Location of the industry
5. Names of directors
6. Authorised and proposed issue capital to the public
7. Dates date of opening and closing the subscription list.
8. Minimum subscription
9. Names of brokers/ underwriters/ banker's/ managers and registers to the issue

Merits of issue through prospectus
1.Sale through prospectus has the advantage of inviting a large section of the investing public through advertisement.
2.It is a direct method and no intermediate is are involved in it.
Demerits:

1. It is an expensive method. the company has to incur expenses on printing of prospectus, advertisement ,banks commission, underwriting commission, legal charges, stamp duty, listing fee and registration charges.
2. This method is suitable only for large issues.

Offer for sale
In this method shares are taken up by a third party in bulk. Later, statement like prospectus is issued for sale of shares to the public.
Thus, offer for sale consists of two stages:
The first stage is a direct sale by the issuing company to the issue house and brokers at an agreed price.
In the second stage the intermediaries resale the above securities to the ultimate investors.
The advantage of this method is that the company is relieved from the problem of printing and advertisement of prospectus and making allotment of shares.

Placement
Under this method all the shares are sold to individuals and Institutions directly by making a private appeal to them.
Advantages
1. In a depressed market conditions when the issues are not likely to get public response through prospectus placement method is a useful method of floatation of shares.
2.This method is suitable when small companies issue their shares.
3. It is a cost and time effective way of raising funds for the corporates.
The main disadvantage of this method is that the securities are not widely distributed to the large section of investors.
A selected group of the small investors are able to buy a large number of shares and get majority holding in a company.

Rights issue
Rights issue is a method of raising capital in the market by an existing company.
A right means and option to buy certain securities at a certain privileged price within a certain specified period. Shares so offered to the existing share holders are called right shares.
Advantages
1. Cost of issue is minimum.there is no underwriting brokerage advertising and printing of prospectus expenses.
2.It ensures equitable distribution of shares to all existing shareholders and so control of company remains and disturb as proportionate ownership in the company remains the same.

Secondary Market : Stock Exchanges

Secondary market is a market in which existing securities are resold or traded.

In other words secondary market consists of that portion of the capital market where the previously issued securities are transacted.
This market is also known as the stock market.
In India the secondary market consists of recognised stock exchanges.
Various types of securities like equity shares, preference shares, debentures are traded in the stock market.

Equity shares
Equity shares are commonly referred to common stock or ordinary shares.
Share capital of a company is divided into a number of small units of equal value called shares.
The term stock is the aggregate of the members fully paid up shares of equal value merged into one fund. It is a set of stairs put together in a bundle.
The stock is expressed in terms of money and not as many shares.
Equity share represent the ownership position in a company.
The Equity shareholders are entitled to get the dividend on their investment.
Equity shareholders have the right to attend the company's meeting and they can vote in the meeting.
Equity share capital is a permanent capital.
Preference Shares
Preference shares are hybrid in nature.
It is an ownership security like an ordinary share but carries a fixed rate of return(dividend) like a debenture.
The holders of preference shares are entitled to income after the claims of creditors of the company have been met,but before ordinary shareholders receive any income.
Preference shares require a fixed rate of dividend.
Preference share holders do not have any voting rights.

Debentures and Bonds
Debenture or bond is a a creditorship security with a fixed rate of return, fixed maturity period, perfect income certainty and low capital uncertainty.
Debentures are generally issued by the private sector companies as a long term promissory note for raising loan capital.
Bond is an alternative form of debenture.Public Sector companies and Financial Institutions issue bonds.

Functions of Stock Exchange
1. Liquidity and marketability of securities
2. Safety of funds
3. Supply of long term funds
4. Flow of capital to profitable ventures
5. Motivation for improved performance
6. Promotion of investment
7. Marketing of new issues

Role of stock exchange

Stock Exchange refers to an organised market place where existing securities can be regularly purchased and sold.
They enhance the efficiency of the flow of savings.
The existence of these markets fulfils a basic need of the investors namely liquidity. In these markets , holders of securities can easily dispose of their securities and obtain cash.stock exchanges and important role in India's industrial growth as quickly as from the discussion below:
1.Mobilisation of savings and acceleration of capital formation.
2. Proper channelization of funds
3. Promotion of industrial growth
4. Raising long term capital
5. Ready and continues market.

Listing of Securities
Listing tennis registration of security as official e approved for dealing on trading on a stock exchange.
It means the admission of the securities of a company to trading privileges on a stock exchange and tour quotation of its share price.
The principal objectives of listing are to provide marketability and impart liquid and free negotiability to securities.
It protects the interest of shareholders and general investing public.
stock exchange provides a venue for savings to flow into corporate sector through trading in the securities of the companies.
Every recognised stock exchange has the power to make bylaws for the listing of securities on the stock exchange.

Procedure for listing
The company seeking listing on the the stock exchange should make a letter of application first.
Application form is to be submitted to the stock exchange along with the supporting documents.
The information to be supplied in the application should give a complete and fair picture of the company and include memorandum and articles of association, debenture trust deed, prospectus, underwriting agreements, promoters and collaboration agreements, directors report ,balance sheet and profit and loss account and short history of the company giving out the details of its activities and other related matters.
finally the company has to enter into a listing agreement with the stock exchange in a specified form and pay the initial listing fees.
Agreement contains and exhaustive list of do's and don'ts in respect of the listed shares of the company.

Listing requirements
The company's desire of listing their shares on the stock exchange should first consult the relevant regional Stock Exchange where the head office of the company is located and arrived at a mutually agreeable schedule of meeting these requirements.

Provisions of the companies act 1956 in regard to listing of securities are as follows:
1.A company which offers its shares are debentures to the public shall make an application to one or more stock exchanges for listing of shares or debentures.
2.The prospectus shall state the names of stock exchanges to the listing applications are proposed to be made.
3.The minimum issued capital of company must be rupees 30000000 of which at least rupees 1.80 crore in face value must be offered to the general public.
4.Companies having a paid up value of rs 10 crore and above are required to get their shares listed on more than one stock exchange in addition to the regional Stock Exchange.
5.In case of default in refunding the company and every director and every officer of the company who is in default sell jointly liable to repay all such monies with interest at the rate 15%.

Advantages of listing
1. Facilitates buying and selling securities
2. Ensurers liquidity
3. Offers wide publicity
4. Assures finance
5. Enables Borrowing
6. Protects investors.

Stock exchanges in India
The first organised in India was started in Bombay in 1875.
In 1894 the Ahmedabad stock exchange was started to facilitate dealings in the shares of textile mills.
At present there are 23 stock exchanges operating in India.

All stock exchanges have their own separate governing boards.
These governing board consist of elected members, directors public representatives, government and SEBI nominees.

The National Stock Exchange of India (NSE) was incorporated in November 1992 bi IDBI and other all India Financial Institutions and became recognised Stock Exchange from 26 April 1993 to provide nationwide stock trading facilities.
The Pherwani committee recommended establish the NSE with a view to provide single market.

Objectives of the NSE
1. To provide nationwide completely transparent securities trading system to investors by using suitable communication network.
2. To provide shorter settlement cycles and book entry settlement system.
3. To bring the Indian stock market in line with international markets.
4. To promote the secondary market in debt instruments such as government and corporate bonds.
5. To check the insider trading.

6. Provide the listing facilities to PSUs.
7. To professionalise the members to more competent.
8.To create more employment opportunities for the finance professional in the orbit of the capital market.
9.To protect the members from the default risks.

Market segments of NSE

NSE has two separate market segments
The wholesale debt market segment
The capital market segment

Wholesale Debt Market Segment(WDMS)
WDMS deals with commercial banks, Financial Institutions, other institutional participants and in PSU bonds ,treasury bills, government securities, commercial papers, certificate of deposits.
The WDMS consists of two parties.
They are trading members and participants.
The trading members are recognised as the members of NSE.
Generally the Financial Institutions body corporates commercial banks are eligible to become the trading members.

The participants are another party in this segment.
The participants involved in buying and selling of the securities.
They are responsible for the settlement of trade.
The participants can be treated as the buyers of the securities for their own requirements. The transactions are executed through trading members.

Capital market segment (CMS)
CMS covers trading in equities and convertible debentures.
This particular segment comprises the securities of medium and large companies with nationwide investors base.
This provides good trading and investment opportunities, increases the volume of trade and increases the liquidty considerably.

Over the Counter Exchange of India (OTCEI)
Over the counter Exchange of India was set up in 1989 as a company.
OTCEI was the first stock exchange in India to introduce screen based automated ringless trading system.
It is promoted by UTI, ICICI, IFCI, LIC, SBI capital markets, CAN BANK Financial services.
OTCEI was established to fulfill the needs of small companies.
It is floor less exchange.
All the activities are computerized.
The dealers are scattered throughout the country and have the access to the central computers.

Objectives of OTCEI
1.to help companies to raise capital from the market at the cheapest cost and on optimal terms.

2. to help investors to access capital market safely and conveniently

3.to cater the needs of the companies which cannot be listed on other official exchanges

4. to eliminate the problems of illiquid securities settlements and unfair prices faced by the investors.

Salient features of OTCEI
1. Nationwide trading
2. Ringless and screen based trading
3. Transparency of transactions
4.Liquidity through market making
5. Fastest delivery and payment
6.Closneess to investors
7. Listing of small and medium-sized companies
8. Only authorised dealers.

Assignment 4
Indian financial system
Attempt any two questions
Q.1. Explain composition of the capital market in India.
Q2. Explain meaning and functions of stock exchange.
Q.3. Explain various methods of floating new issues.