Indian Financial System

UNIT-I

INDIAN FINANCIAL SYSTEM

The structure of the Indian financial system may be summarized in the following schematic representation. Broadly the Indian financial system may be divided into organized and unorganized segments. The organized market consists of commercial banks, development banks, cooperative banks, post-office savings bank operations, stock markets etc. Unorganised financial market operations consist of hundis, money lending, chit funds etc. They operate mainly in the rural areas. However in the urban areas also unorganized money market activities are quite significant. There is no precise estimate of the size of the unorganized money market. It is generally expected that the relative size of the unorganized money market transactions would decline over time

Definition of Financial System

- "It is a set of institutions instruments and markets which fosters saving and channels them to their most efficient use". **H.R. Machiraju.**
- "Financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption"**. Van Horne**.
- "Financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provides the principal means by which savings are transformed into investments". **Prasanna Chandra.**

Role of Financial System in Economic Development:

1. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through savinginvestment process. This savings – investment process is called capital formation.
2. It helps to monitor corporate performance.
3. It provides a mechanism for managing uncertainty and controlling risk.
4. It provides a mechanism for the transfer of resources across geographical boundaries.

5. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries)
6. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
7. It promotes the process of capital formation.
8. It helps in promoting the process of financial deepening and broadening.

FUNCTIONS OF FINANCIAL SYSTEM:

A financial system is the network of markets, institutions, and instruments that connects people who have surplus money with people who need money.The primary functions of a financial system include:

- **Mobilization of Savings:** It collects small, scattered savings from individuals and households and pools them together into large sums of capital for productive investments.
- **Capital Allocation:** It channels these pooled funds toward businesses, entrepreneurs, and projects that offer the highest economic potential.
- **Liquidity Provision:** It allows savers and investors to convert financial assets (like stocks, bonds, or deposits) into cash quickly without losing value.
- **Payment Facilitation:** It provides safe, low-cost methods for buying and selling goods and services through checks, credit cards, digital wallets, and banking networks.
- **Risk Management:** It helps individuals and businesses hedge against life, health, property, and market risks via insurance policies and derivative instruments
- **Price Discovery:** Financial markets determine the prices of assets and the equilibrium interest rates based on the supply of savings and the demand for borrowing
- **Information Dissemination:** It provides public price data, company performance updates, and credit evaluations to help participants make informed financial decisions
- **Geographical and Maturity Transformation:** It transfers money across regions and bridges short-term savings with long-term business loans

Structure of Indian Financial System –

1. Meaning of Indian Financial System

The Indian Financial System is a system that consists of financial institutions, financial markets, financial instruments and financial services. It helps to transfer money from people who have surplus funds (savers) to people or businesses who need funds (borrowers).

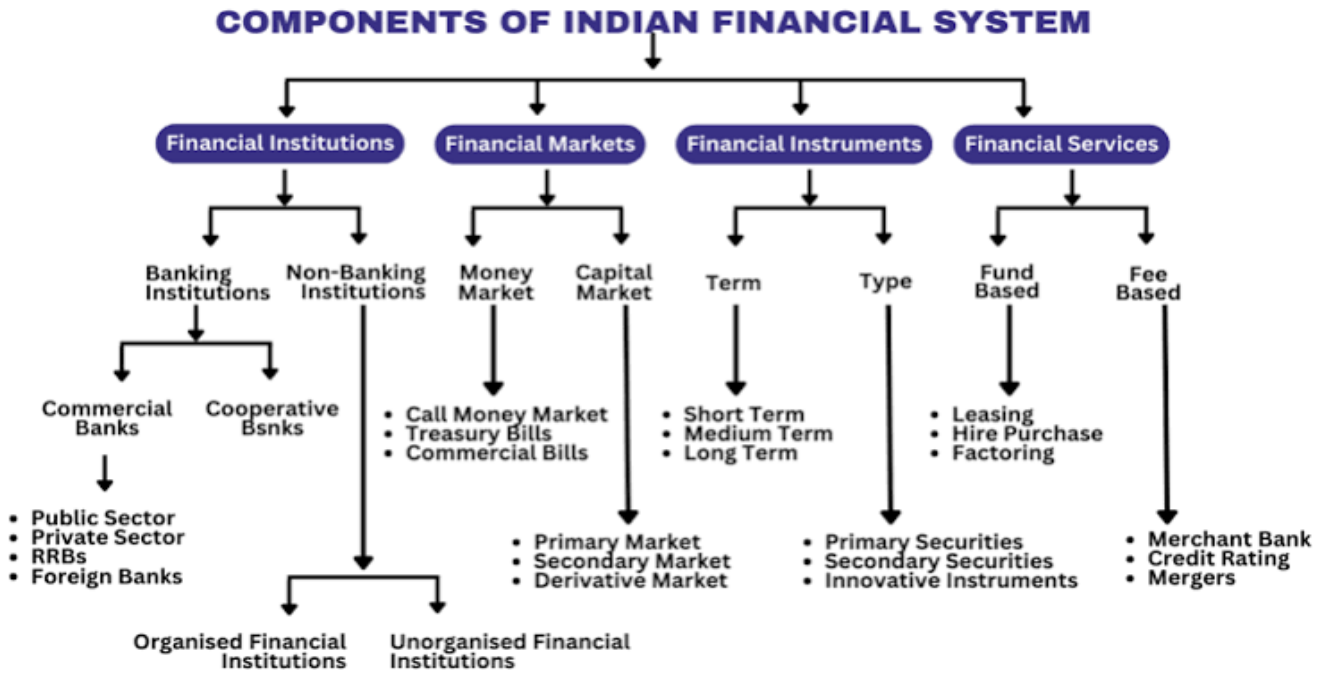
In simple words, the Indian Financial System connects savers, investors, banks, companies and the government to promote economic development.

Example: A person deposits money in a bank. The bank uses these deposits to provide loans to businesses and individuals. This process helps in the proper utilisation of money.

2. Structure of Indian Financial System

The Indian Financial System consists of four major components:

- Financial Institutions
- Financial Markets
- Financial Instruments
- Financial Services



Components of Indian Financial System

1. Financial Institutions

Meaning:

Financial institutions are organisations that deal with money and provide various financial services such as accepting deposits, providing loans, offering insurance and supporting investments.

They act as intermediaries between people who save money and people who need money.

Types of Financial Institutions

A. Banking Institutions

Banking institutions are financial organisations that accept deposits from the public and provide loans to individuals and businesses.

Types of banking institutions:

1. Reserve Bank of India (RBI): RBI is the central bank of India. It controls and regulates the banking system and monetary policy of the country.

Example: RBI controls the supply of money and supervises banks.

2. Commercial Banks: These banks accept deposits, provide loans and offer other banking services to the public.

Example: State Bank of India (SBI), HDFC Bank and ICICI Bank.

3. Co-operative Banks: These banks provide financial assistance mainly to farmers, small businesses and members of cooperative societies.

Example: Urban Cooperative Banks and State Cooperative Banks.

4. Regional Rural Banks (RRBs): These banks provide banking and credit facilities to people living in rural areas, especially farmers, agricultural labourers and small entrepreneurs.

Example: Banks serving rural communities and agricultural borrowers.

B. Non-Banking Financial Institutions (NBFIs)

Non-banking financial institutions provide financial services such as loans, insurance, investment and financial assistance. They do not perform all the functions of commercial banks.

Important institutions:

1. NABARD (National Bank for Agriculture and Rural Development): Provides financial support for agriculture, rural development and rural banking.

2. SIDBI (Small Industries Development Bank of India): Provides financial assistance and support to Micro, Small and Medium Enterprises (MSMEs).

3. EXIM Bank (Export-Import Bank of India): Provides financial assistance to businesses involved in international trade, exports and imports.

4. NHB (National Housing Bank): Supports and promotes housing finance institutions and the housing finance sector.

5. Insurance Companies: Provide financial protection against risks such as accidents, illness, death and property loss.

Functions of Financial Institutions:

a) Accept deposits from the public.
b) Provide loans and advances.
c) Encourage savings and investments.
d) Support industrial and agricultural development.
e) Create employment opportunities.
f) Promote economic growth.

2. Financial Markets

Financial markets are markets where financial assets such as shares, bonds and other securities are issued and traded.

These markets help companies, individuals and governments raise money for their financial requirements.

Types of Financial Markets

A. Money Market

The money market is a market where short-term financial instruments are borrowed and lent.

The maturity period is generally up to one year.

Features:

Deals with short-term funds.

Provides liquidity to financial institutions and businesses.

Helps meet temporary financial requirements.

Instruments are generally highly liquid.

Examples:

1. Treasury Bills: Short-term government securities issued by the Government of India to raise funds.

2. Commercial Papers: Unsecured short-term instruments issued by financially strong companies to meet their working capital requirements.

3. Certificate of Deposit: A negotiable short-term deposit instrument issued by eligible banks and financial institutions.

4. Call Money: Very short-term funds borrowed and lent, generally for one day.

Example: A company needs money for three months to purchase raw materials. It may raise short-term funds through commercial paper.

B. Capital Market

The capital market is a market where long-term funds are raised and invested.

It helps companies and governments obtain funds for expansion, development and long-term projects.

Features:

i. Deals with long-term finance.
ii. Encourages savings and investments.
iii. Helps in capital formation.
iv. Supports industrial and economic development.

Examples:

1. Shares
2. Debentures
3. Bonds
4. Government securities

Types of Capital Market

1. Primary Market: It is a market where new securities are issued for the first time to investors.

Example: A company issues shares to the public through an Initial Public Offering (IPO).

2. Secondary Market: It is a market where existing securities are bought and sold among investors.

Example: Buying and selling shares through the National Stock Exchange (NSE) or Bombay Stock Exchange (BSE).

3. Financial Instruments

Financial instruments are financial contracts or documents that represent ownership, borrowing or financial claims between two parties.

They are used to raise funds, make investments and transfer financial risks.

Types of Financial Instruments

1. Shares: Shares represent ownership in a company. A person who purchases shares becomes a shareholder and may receive dividends.

Example: Purchasing shares of Reliance Industries.

2. Debentures: Debentures are debt instruments issued by companies to borrow money from investors. The company generally pays interest to debenture holders.

Example: A company issues debentures to collect funds for business expansion.

3. Bonds: Bonds are debt instruments issued by governments or companies to raise money. The issuer generally pays interest and repays the principal according to the terms.

Example: Government bonds issued to raise funds for public projects.

4. Treasury Bills: These are short-term government securities used to meet the short-term borrowing requirements of the government.

5. Commercial Papers: These are unsecured short-term financial instruments issued by eligible companies to meet temporary financial needs.

6. Certificate of Deposit: It is a negotiable deposit instrument issued by eligible banks and financial institutions for a specified period.

Functions of Financial Instruments:

- Help companies and governments raise funds.
- Provide investment opportunities to investors.
- Facilitate financial transactions.
- Help in the transfer of financial risks.
- Support economic development.

4. Financial Services

Financial services are services provided by banks, financial institutions and other financial organisations to help individuals and businesses manage their money.

These services include banking, insurance, investment, leasing and financial advice.

Types of Financial Services

1. Banking Services: These services include accepting deposits, providing loans, money transfers and payment facilities.

Example: Savings accounts, current accounts and internet banking.

2. Insurance Services: Insurance provides financial protection against unexpected risks and losses.

Example: Life insurance, health insurance and vehicle insurance.

3. Leasing: Leasing is an arrangement in which the owner of an asset allows another person or business to use it for a specified period in return for regular payments.

Example: A company takes machinery on lease instead of purchasing it.

4. Hire Purchase: Hire purchase is a system in which a person purchases an asset by paying instalments over a period. Ownership generally transfers after all instalments are paid, according to the agreement.

Example: Purchasing a car through monthly instalments under a hire-purchase agreement.

5. Mutual Funds: Mutual funds collect money from different investors and invest it in shares, bonds and other securities.

Example: Equity mutual funds and debt mutual funds.

6. Merchant Banking: Merchant banking provides financial advice and assistance to companies for raising capital, managing public issues and corporate restructuring.

Example: Helping a company issue shares through an IPO.

7. Credit Rating: Credit rating evaluates the ability of a borrower or company to repay its debt. It helps investors understand credit risk.

Example: CRISIL, ICRA and CARE Ratings.

8. Stock Broking: Stockbroking services help investors buy and sell shares and other securities through stock exchanges.

Example: Groww, Zerodha and Angel One.

Functions of Financial Services:

a. Provide financial assistance to individuals and businesses.
b. Encourage savings and investments.
c. Help in managing financial risks.
d. Support business expansion.
e. Improve financial transactions.
f. Promote economic development.

Importance of Indian Financial System

The Indian Financial System plays an important role in the development of the Indian economy.

1. Mobilisation of Savings

It encourages people to save money through banks, deposits, insurance and investment schemes. These savings are used for productive purposes.

2. Capital Formation

It helps collect money from individuals and institutions and converts savings into investments. This increases the capital available for economic activities.

3. Investment Opportunities

It provides different investment opportunities such as shares, bonds, mutual funds and fixed deposits. Investors can select suitable investment options.

4. Economic Development

It provides financial support to agriculture, industries, trade and other business activities. This contributes to the overall development of the country.

5. Employment Generation

Financial institutions provide funds to businesses for starting and expanding their activities. This creates new employment opportunities.

6. Financial Stability

Regulatory institutions such as RBI and SEBI supervise financial activities and help maintain stability and confidence in the financial system.

7. Business Growth

It provides short-term and long-term financial assistance to businesses. This helps companies purchase machinery, expand operations and introduce new products.

Weaknesses of the Indian Financial System

The Indian Financial System plays an important role in the economic development of the country. However, it has certain weaknesses that affect its efficiency, stability and **growth. The major weaknesses are explained below.**

1. Lack of Financial Inclusion:

Financial inclusion means providing banking and financial services to all sections of society. In India, many people, especially those living in rural and remote areas, do not have easy access to banking, insurance and other financial services. This limits their opportunities for savings and investment.

2. Regional Imbalances:

There is an unequal distribution of financial institutions across different regions of India. Banking and financial services are mostly concentrated in urban and developed areas, whereas rural and backward regions have limited financial facilities. This creates regional inequalities in economic development.

3. Lack of Financial Literacy:

Financial literacy refers to the knowledge and understanding of financial products and services. Many people in India are unaware of banking facilities, insurance policies, investment opportunities and financial planning. Due to a lack of financial knowledge, people may make poor financial decisions.

4. High Non-Performing Assets (NPAs):

Non-Performing Assets refer to loans on which borrowers fail to make interest or principal repayments for a specified period. High NPAs affect the profitability and financial position of banks. They also reduce the lending capacity of banks and create problems in the banking system.

5. Inefficient Credit Allocation:

Credit allocation refers to the distribution of loans to different sectors of the economy. In India, small businesses, farmers and entrepreneurs sometimes face difficulties in obtaining loans from financial institutions. This affects business development, agricultural growth and employment opportunities.

6. Growth of Black Money:

Black money refers to income earned through illegal activities or income that is not reported to the government for taxation. The growth of black money leads to tax evasion, corruption and economic inequality. It also affects the transparency and efficiency of the Indian Financial System.

7. Dependence on Informal Financial Sources:

Many people, particularly in rural areas, depend on moneylenders and other informal sources for financial assistance. These sources often charge high rates of interest and may impose unfair conditions on borrowers. This creates a financial burden on poor and economically weaker sections.

8. Lack of Coordination:

The Indian Financial System consists of various financial institutions, banks and regulatory authorities. Sometimes, a lack of proper coordination among these institutions affects the smooth functioning of the financial system. Better cooperation is necessary for effective financial management and development.

9. Cybersecurity Risks and Financial Frauds:

The growth of digital banking and online financial transactions has increased the risk of cybercrimes, phishing, hacking and online fraud. These activities may result in financial losses and reduce public confidence in digital financial services.

10. Complex Banking Procedures:

Some banking and financial services involve lengthy documentation, complicated procedures and strict eligibility requirements. These difficulties create problems for small borrowers, farmers and people with limited financial knowledge when accessing financial services.

UNIT -II

Meaning and Definitions of Money Market

1. Meaning of Money Market

Money Market refers to a part of the financial market where short-term financial instruments are borrowed and lent. It deals with the borrowing and lending of funds for a short period, generally up to one year.

The money market helps banks, financial institutions, companies and the government to meet their short-term financial requirements. It provides liquidity to the financial system and helps maintain the smooth flow of funds in the economy.

In India, the Reserve Bank of India (RBI) plays an important role in regulating and controlling the money market.

2. Definitions of Money Market

1. According to financial terminology, the money market is a market for short-term financial assets that are close substitutes for money and are easily convertible into cash.
2. Money Market is a financial market that deals with short-term borrowing, lending and trading of financial instruments to meet the liquidity requirements of banks, businesses and government institutions.

Features of Money Market

The Money Market is an important part of the Indian Financial System. It deals with short-term borrowing and lending of funds, generally for a period of up to one year. It provides short-term financial assistance to banks, financial institutions, business organisations and the government. The important features of the money market are explained below.

1. Short-Term Funds:

The money market deals with the borrowing and lending of short-term funds, generally for a period not exceeding one year. These funds are used to meet temporary financial requirements such as working capital, payment of salaries, purchase of raw materials and other short-term business expenses.

2. High Liquidity:

Liquidity is one of the important features of the money market. Money market instruments can be easily converted into cash without significant loss in value. This helps banks, companies and financial institutions meet their immediate cash requirements.

3. Low Risk:

Money market instruments generally carry lower risk compared to long-term financial instruments. This is because they have shorter maturity periods. However, the level of risk depends on the issuer and the type of instrument.

4. No Fixed Physical Location:

The money market does not operate from a particular physical location like a traditional market. Transactions are generally conducted through banks, financial institutions, brokers and electronic trading platforms. This makes the transfer of short-term funds easier and faster.

5. Participants in the Money Market:

Various institutions participate in the money market, including commercial banks, cooperative banks, the Reserve Bank of India, financial institutions, government organisations and corporate companies. These participants borrow and lend money to meet their short-term financial requirements.

6. Central Bank Regulation:

The Reserve Bank of India (RBI) plays an important role in regulating and controlling the Indian money market. It uses monetary policy instruments such as repo rate, cash reserve ratio (CRR) and other liquidity management measures to maintain monetary stability and control the supply of money.

7. Short-Term Financial Instruments:

The money market deals with various short-term financial instruments such as Treasury Bills, Commercial Papers, Certificates of Deposit, Call Money and Repurchase Agreements. These instruments help borrowers raise short-term funds and provide investment opportunities to investors.

8. Wholesale Market:

The money market mainly operates as a wholesale market where large amounts of money are borrowed and lent. Banks, financial institutions, government bodies and large business organisations are the major participants in these transactions.

9. Helps in Maintaining Liquidity:

The money market helps financial institutions maintain sufficient cash balances to meet their daily financial obligations. It allows institutions with surplus funds to lend money to institutions facing temporary shortages of funds.

10. Flexible Interest Rates:

Interest rates in the money market are influenced by the demand and supply of short-term funds, RBI monetary policy and prevailing economic conditions. These rates may change according to market conditions and liquidity requirements.

11. Supports Economic Development:

The money market supports economic development by providing short-term funds to different sectors of the economy. It helps businesses manage their working capital, supports banking operations and assists the government in meeting short-term financial requirements.

12. Close Relationship with the Banking System:

The money market is closely connected with the banking system. Commercial banks are major participants in this market and use it to manage their short-term cash requirements, maintain liquidity and lend surplus funds to other institutions.

Objectives of Money Market

The Money Market is an important component of the Indian Financial System. It deals with short-term borrowing and lending of funds, generally for a period of up to one year. The main objective of the money market is to provide short-term financial assistance to banks, financial institutions, business organisations and government institutions. The major objectives are explained below.

1. Providing Short-Term Finance:

The main objective of the money market is to provide short-term funds to individuals, banks, financial institutions, business organisations and the government. These funds help them meet their immediate financial requirements, such as payment of salaries, purchase of raw materials, payment of bills and other day-to-day expenses.

2. Maintaining Liquidity:

The money market aims to maintain adequate liquidity in the financial system. Liquidity refers to the availability of cash or easily convertible financial assets to meet immediate financial obligations. It helps banks and other financial institutions maintain sufficient funds to carry out their daily operations smoothly.

3. Mobilisation of Savings:

The money market encourages individuals, institutions and organisations to invest their surplus funds in short-term financial instruments. It collects idle money from different sources and channels it towards productive economic activities. This helps in the effective utilisation of available financial resources.

4. Ensuring Proper Utilisation of Funds:

Another important objective of the money market is to ensure the proper utilisation of surplus funds. It transfers funds from institutions having excess money to institutions facing temporary shortages. This helps avoid the unnecessary holding of idle funds and improves the efficiency of financial resources.

5. Maintaining Monetary Stability:

The money market supports the Reserve Bank of India in implementing monetary policy and maintaining monetary stability. Through various monetary policy instruments, the RBI influences the availability and cost of short-term credit in the economy. This helps control inflation and maintain stability in the financial system.

6. Promoting Economic Development:

The money market aims to support economic development by providing short-term financial assistance to different sectors of the economy. It helps businesses, industries, banks and government organisations manage their financial requirements and continue their economic activities without interruption.

7. Facilitating Credit Control:

The money market helps the Reserve Bank of India regulate the flow of credit in the economy. By influencing short-term interest rates and liquidity conditions, the RBI can control excessive borrowing and maintain a balance between the demand and supply of money.

8. Encouraging Investment Opportunities:

The money market provides investment opportunities through instruments such as Treasury Bills, Commercial Papers and Certificates of Deposit. These instruments allow investors and financial institutions to invest surplus funds for short periods and earn returns according to the terms of the instruments.

Importance of Money Market

The money market plays a vital role in the smooth functioning of the Indian economy. It provides short-term funds, maintains liquidity, supports banking operations and helps the government and business organisations manage their financial requirements. The major importance of the money market is explained below.

1. Helps in Meeting Short-Term Financial Requirements:

The money market provides short-term financial assistance to banks, companies and government institutions. Business organisations use these funds to meet their working capital requirements, purchase raw materials, pay wages and manage daily business activities. This ensures the continuous functioning of business operations.

2. Development of Banking System:

The money market plays an important role in the development of the banking system. Commercial banks use the money market to borrow funds when they face temporary shortages and lend surplus funds when they have excess liquidity. This improves the efficiency and stability of banking operations.

3. Provides Liquidity to Financial Institutions:

The money market helps financial institutions maintain adequate cash balances to meet their immediate financial obligations. It allows institutions to convert short-term financial assets into cash easily. Therefore, it reduces liquidity problems and supports the smooth functioning of financial institutions.

4. Helps in Implementing Monetary Policy:

The money market provides an effective mechanism for the Reserve Bank of India to implement monetary policy. The RBI uses instruments such as repo rate, reverse repo operations and other liquidity management measures to influence the supply of money and credit in the economy. This helps maintain price stability and control inflation.

5. Promotes Industrial and Business Development:

The money market provides short-term funds to industries and business organisations for their operational activities. These funds help companies purchase raw materials, maintain inventory, pay employees and meet other working capital requirements. As a result, it supports industrial production and business expansion.

6. Helps in Government Financing:

The government uses the money market to meet its short-term financial requirements through instruments such as Treasury Bills. These instruments help the government manage temporary gaps between its income and expenditure without depending entirely on long-term borrowing.

7. Encourages Savings and Investment:

The money market encourages individuals, banks and financial institutions to invest their surplus funds in short-term financial instruments. It provides investment opportunities with different maturity periods and risk levels. This helps promote savings and the productive utilisation of financial resources.

8. Maintains Balance Between Demand and Supply of Money:

The money market helps maintain a balance between the demand and supply of short-term funds. When the demand for money increases, financial institutions can arrange funds through money market transactions. Similarly, surplus funds can be invested when the supply of money is high. This supports financial stability.

9. Promotes Financial Market Development:

The money market contributes to the overall development of the financial market by creating opportunities for borrowing, lending and investing in short-term instruments. It strengthens the relationship between banks, financial institutions, government organisations and business enterprises.

10. Helps in Controlling Inflation:

The money market assists the RBI in controlling inflation by influencing short-term interest rates and credit availability. When inflationary pressures increase, monetary policy measures can be used to reduce excessive liquidity and borrowing. This helps maintain price stability in the economy.

11. Provides Investment Flexibility:

The money market offers flexibility to investors because its instruments generally have short maturity periods. Investors can select instruments according to their financial requirements and liquidity needs. This makes it easier to manage short-term investments and cash balances.

12. Supports Overall Economic Growth:

The money market supports the overall economic growth of the country by ensuring the continuous availability of short-term funds. It helps agriculture, industries, trade, banking and government activities function smoothly. The efficient flow of funds improves productivity, employment opportunities and economic development.

Components of Money Market

The money market is an important part of the Indian Financial System that deals with short-term borrowing and lending of funds, generally for a period of up to one year. The money market consists of various institutions, participants and financial instruments that help in mobilising short-term funds and maintaining liquidity in the economy.

The major components of the Indian Money Market are explained below.

1. Organised Money Market

The organised money market is a well-structured and regulated part of the financial system. It operates under the supervision and control of the Reserve Bank of India (RBI). It includes commercial banks, cooperative banks and other recognised financial institutions. These institutions provide short-term loans, accept deposits and participate in money market transactions according to RBI guidelines.

Major institutions of the organised money market:

a) Reserve Bank of India (RBI):

The Reserve Bank of India is the central bank of the country and plays an important role in regulating the Indian money market. It controls the supply of money and credit through monetary policy. It also manages liquidity in the banking system and maintains monetary stability.

b) Commercial Banks:

Commercial banks are major participants in the money market. They accept deposits from the public and provide loans to individuals and business organisations. They also borrow and lend short-term funds to manage their daily cash requirements.

c) Cooperative Banks:

Cooperative banks provide banking and credit facilities mainly to their members, farmers, small businesses and rural communities. They help meet short-term financial requirements, particularly in agricultural and rural sectors.

d) Financial Institutions:

Financial institutions participate in money market activities by borrowing and lending short-term funds. They help mobilise savings and provide financial assistance to different sectors of the economy.

2. Unorganised Money Market

The unorganised money market refers to the traditional financial sector that operates outside the formal banking and regulatory structure. It consists of indigenous bankers, moneylenders, pawn brokers and other informal financial agencies. These institutions provide loans mainly to individuals, small traders and rural people who may not have easy access to formal banking services.

Major institutions of the unorganised money market:

a) Indigenous Bankers:

Indigenous bankers are traditional financial institutions that provide loans and accept deposits from customers. They mainly operate in local and regional markets and provide financial assistance to small traders and business people.

b) Moneylenders:

Moneylenders provide loans to individuals, farmers and small business owners for personal and business purposes. They generally offer quick loans with fewer formalities, but may charge high rates of interest.

c) Chit Funds:

Chit funds are financial arrangements in which a group of people contribute a fixed amount of money at regular intervals. The collected amount is given to one member through an auction or other agreed selection method. They are regulated under the Chit Funds Act, 1982.

d) Nidhis:

Nidhis are mutual-benefit financial companies that mainly operate in South India. They encourage savings among their members and provide loans to members according to their rules and regulations.

3. Money Market Instruments

Money market instruments are short-term financial securities used for borrowing and lending funds. They generally have a maturity period of up to one year.

a) Treasury Bills (T-Bills):

Treasury Bills are short-term government securities issued by the Government of India to meet its short-term financial requirements. They are issued at a discount and redeemed at face value on maturity. They are generally considered low-risk financial instruments.

b) Commercial Papers (CP):

Commercial Papers are unsecured short-term financial instruments issued by eligible companies to raise funds for working capital and other short-term financial requirements. They are generally issued for periods ranging from seven days to one year.

c) Certificates of Deposit (CD):

Certificates of Deposit are negotiable money market instruments issued by eligible banks and financial institutions. They help these institutions raise short-term funds from investors for a specified period.

d) Call Money:

Call Money refers to short-term funds borrowed and lent mainly between banks and eligible financial institutions for one day. It helps banks manage their daily liquidity requirements.

e) Commercial Bills:

Commercial Bills are financial instruments used in trade transactions. They represent a written promise or order to pay a specified amount on a future date. Businesses use them to obtain short-term finance against credit sales.

f) Repurchase Agreements (Repo):

A Repurchase Agreement is a short-term borrowing arrangement in which securities are sold with an agreement to repurchase them at a later date at a predetermined price. It helps financial institutions manage their short-term liquidity.

4. Sub-Markets of Money Market

The Indian money market also consists of different sub-markets through which short-term funds are borrowed and lent.

a) Call Money Market:

The call money market deals with borrowing and lending of funds for one day. It helps banks meet their immediate cash requirements and maintain daily liquidity.

b) Notice Money Market:

The notice money market deals with short-term funds borrowed and lent for a period of more than one day and up to 14 days. It provides temporary financial assistance to banks and financial institutions.

c) Term Money Market:

The term money market deals with short-term borrowing and lending of funds for a period exceeding 14 days and up to one year. It helps financial institutions manage their short-term financial requirements.

d) Treasury Bills Market:

The Treasury Bills Market deals with the purchase and sale of short-term government securities. It provides a safe investment opportunity and helps the government raise short-term funds.

e) Commercial Bills Market:

The commercial bills market deals with the discounting and rediscounting of commercial bills. It provides working capital finance to business organisations and supports trade transactions.

f) Certificate of Deposit Market:

This market deals with the issue and trading of Certificates of Deposit by eligible banks and financial institutions. It helps mobilise short-term funds from investors.

Players in the Indian Money Market

Meaning: Players in the money market are the individuals, institutions and organizations that participate in borrowing, lending and investing short-term funds. They help maintain liquidity and ensure the smooth functioning of the financial system.

The major players in the Indian money market are explained below.

1. Government

The Central and State Governments are important participants in the money market. They borrow short-term funds to meet their financial requirements and manage temporary budget deficits. They raise funds through instruments such as Treasury Bills and Cash Management Bills.

2. Reserve Bank of India (RBI)

The Reserve Bank of India is the central bank and the regulator of the Indian money market. It controls and supervises money market activities. It maintains liquidity in the banking system, regulates interest rates and implements monetary policies to maintain economic stability.

3. Commercial Banks

Commercial banks are the major participants in the money market. They accept deposits from the public and provide short-term loans to individuals and businesses. They also borrow and lend funds among themselves to manage their daily cash requirements and maintain liquidity.

4. Financial Institutions

Financial institutions such as NABARD, SIDBI, EXIM Bank and other development financial institutions participate in money market activities. They provide short-term financial assistance and help businesses, industries and agricultural sectors meet their financial requirements.

5. Discount and Finance House of India (DFHI)

The Discount and Finance House of India was established to promote the development of the Indian money market. It deals in short-term financial instruments such as Treasury Bills and commercial bills. It helps improve liquidity and provides an active secondary market for money market instruments.

6. Mutual Funds

Mutual funds collect money from investors and invest it in different financial instruments. Money market mutual funds invest in short-term instruments such as Treasury Bills, Commercial Papers and Certificates of Deposit. They provide investors with liquidity and opportunities for short-term investment.

7. Insurance Companies

Insurance companies collect premiums from policyholders and invest their funds in different financial instruments. They participate in the money market by investing surplus funds in permitted short-term instruments to earn returns and maintain liquidity.

8. Corporate Units

Corporate units include private companies, public companies and business organizations. They participate in the money market to raise short-term funds for working capital requirements, payment of salaries, purchasing raw materials and meeting other business expenses. They issue Commercial Papers to obtain short-term finance.

9. Primary Dealers

Primary dealers are financial institutions authorized to deal in Government securities. They participate in the purchase and sale of government securities and help the government raise funds. They also support liquidity and trading activities in the money market.

10. Non-Banking Financial Companies (NBFCs)

NBFCs provide financial services such as loans, asset financing and investment activities. They participate in money market transactions through eligible instruments and permitted market segments. They help meet the short-term financial requirements of businesses and individuals.

11. Brokers and Dealers

Brokers and dealers act as intermediaries between borrowers and lenders. They facilitate the buying and selling of money market instruments and help participants complete financial transactions efficiently.

Recent Developments in the Indian Money Market

Recent developments in the Indian money market refer to the new changes, reforms, technological advancements and financial innovations introduced to improve the efficiency, transparency, liquidity and functioning of the money market. These developments help borrowers, lenders, banks and financial institutions manage their short-term financial requirements more effectively.

The Indian money market has undergone several important changes due to financial reforms, digital technology, RBI initiatives and increasing participation of financial institutions.

Recent Developments in the Money Market

1. Introduction of Digital Transactions

The Indian money market has witnessed significant growth in digital financial transactions. Technology has made financial transactions faster, easier and more transparent. Electronic payment systems and digital banking facilities have improved the transfer of funds between banks and financial institutions.

2. Development of Repo and Reverse Repo Markets

The repo and reverse repo markets have become important components of the Indian money market. The RBI uses repo-related operations to manage liquidity in the banking system. These mechanisms help banks borrow or invest short-term surplus funds and maintain financial stability.

3. Growth of Treasury Bills

Treasury Bills have become an important short-term investment instrument for banks, financial institutions and investors. The Government of India issues Treasury Bills with maturities of 91 days, 182 days and 364 days. They help the government meet short-term financial requirements and provide investors with relatively safe investment opportunities.

4. Expansion of Commercial Paper Market

The Commercial Paper market has developed as an important source of short-term finance for companies and corporate organizations. Companies issue Commercial Papers to meet their working capital requirements and other short-term expenses. This development has reduced the dependence of eligible companies on traditional bank loans.

5. Growth of Certificate of Deposit (CD)

Certificates of Deposit have become an important instrument for raising short-term funds by banks and eligible financial institutions. Banks issue CDs to mobilize funds and meet their financial requirements. Their increasing use provides flexibility in managing liquidity.

6. Introduction of Electronic Trading Platforms

Electronic trading platforms have improved the efficiency of money market transactions. They provide better access to financial instruments and improve transparency in trading activities. Electronic platforms also help market participants obtain information about interest rates and transaction prices.

7. Role of Reserve Bank of India (RBI)

The RBI has introduced several measures to strengthen the money market and maintain adequate liquidity. It uses monetary policy instruments such as repo operations, variable rate repo and variable rate reverse repo auctions to regulate the supply of money and maintain stability in short-term interest rates.

8. Increased Participation of Mutual Funds

Mutual funds have increased their participation in money market activities. They invest in short-term instruments such as Treasury Bills, Commercial Papers and Certificates of Deposit. Their participation helps improve liquidity and provides additional investment opportunities.

9. Development of Collateralised Money Market

The collateralised money market has gained importance because it allows participants to borrow and lend funds against securities. Tri-party repo and market repo transactions have become major segments of the Indian money market. These arrangements help reduce credit risk and improve the safety of financial transactions.

10. Improved Liquidity Management

The RBI has strengthened liquidity management through various measures, including Open Market Operations (OMO), Cash Reserve Ratio (CRR) changes and liquidity adjustment operations. These measures help maintain an appropriate balance between the demand and supply of money in the banking system.

11. Modernisation of Financial Regulations

The RBI continuously updates financial regulations to improve the functioning of the money market. These regulatory developments aim to improve transparency, strengthen risk management, protect investors and promote financial discipline among market participants.

12. Increase in Money Market Trading Activities

The volume of transactions in the Indian money market has increased significantly. According to the RBI Annual Report for 2025–26, the average daily money market trading volume increased by approximately 16% to ₹6.4 lakh crore from ₹5.5 lakh crore in the previous year. This indicates increased participation and activity in the money market.

UNIT-III

Meaning of Capital Market

The capital market is an important part of the financial system that deals with the buying and selling of long-term financial securities. It provides a platform for companies, government organizations and other institutions to raise long-term funds from investors for investment and business activities.

The capital market helps mobilize savings from individuals and institutions and directs these funds towards productive investment opportunities. It provides finance

for business expansion, establishment of new industries, infrastructure development and other long-term projects.

The capital market mainly deals with financial instruments such as equity shares, preference shares, debentures, bonds and other long-term securities. It connects investors who have surplus funds with organizations that require funds for long-term development.

In India, the capital market plays a significant role in economic growth by encouraging investment, promoting industrial development and creating employment opportunities.

Definitions of Capital Market

1. General Definition:

"Capital market is a market where long-term funds are raised and invested through the purchase and sale of financial securities such as shares, debentures and bonds."

2. Financial Definition:

"Capital market refers to a market that provides facilities for borrowing and lending long-term funds to meet the financial requirements of business organizations and government institutions."

3. Economic Definition:

"Capital market is a financial market that mobilizes savings from different sections of society and channels them into productive investments for economic development."

Difference Between Capital Market and Money Market

The capital market and money market are two important components of the financial system. Both markets help in mobilising savings and providing funds to individuals, businesses and government organisations. However, they differ in terms of maturity period, purpose, instruments, risk, returns and participants.

Basis of Difference	Capital Market	Money Market
1. Meaning	Capital market is a financial market that deals with the raising and lending of long-term funds.	Money market is a financial market that deals with borrowing and lending of short-term funds.
2. Period	It deals with medium-term and long-term financial requirements, generally exceeding one year.	It deals with short-term financial requirements, generally up to one year.
3. Main	Its main objective is to provide	Its main objective is to meet short-term

Objective	long-term finance for business expansion, industrial development and investment projects.	financial requirements and maintain liquidity in the financial system.
4. Nature of Funds	It provides funds for long-term investment and capital formation.	It provides funds for working capital and short-term cash requirements.
5. Instruments	It deals with equity shares, preference shares, debentures, bonds and government securities.	It deals with Treasury Bills, Commercial Papers, Certificates of Deposit, Commercial Bills and Call Money.
6. Participants	Its participants include individual investors, companies, banks, financial institutions, mutual funds and foreign portfolio investors.	Its participants include RBI, commercial banks, financial institutions, primary dealers, mutual funds and eligible corporate entities.
7. Risk	It generally involves higher investment risk, depending on the type of security and market conditions.	It generally involves comparatively lower risk, particularly in high-quality short-term instruments.
8. Return	It offers returns in the form of dividends, interest and capital appreciation.	It generally offers returns in the form of interest or discount income.
9. Liquidity	Liquidity varies depending on the type of security and market demand.	It generally provides high liquidity because the instruments have short maturities.
10. Market Structure	It consists mainly of primary and secondary markets.	It consists of various short-term borrowing, lending and trading segments.
11. Regulation	It is regulated mainly by SEBI, while RBI regulates relevant banking and government securities activities.	It is regulated mainly by the Reserve Bank of India (RBI).
12. Investment Purpose	It encourages long-term investment, capital formation and economic development.	It helps manage short-term funds and maintain liquidity.
13. Nature of Investors	It attracts investors who are interested in medium-term and long-term investments.	It attracts banks, financial institutions, companies and investors seeking short-term investment opportunities.
14. Trading	Securities are traded through recognised stock exchanges and other permitted platforms.	Transactions take place through money market platforms and other authorised financial arrangements.
15. Examples	NSE, BSE and corporate bond markets.	Treasury Bill market, Call Money market and Repo market.
16. Economic Role	It promotes industrial growth, infrastructure development and capital formation.	It supports monetary stability, liquidity management and short-term financial requirements.
17. Maturity	Securities may have maturities extending over several years or	Instruments generally mature within one year.

	may have no fixed maturity, as in equity shares.	
18. Nature of Investment	It is suitable for investors seeking long-term wealth creation, subject to risk.	It is suitable for managing short-term surplus funds and liquidity requirements.
19. Financial Support	It supports the establishment of new businesses and expansion of existing industries.	It supports the daily financial operations of banks, companies and other institutions.
20. Examples of Transactions	Purchasing company shares, investing in bonds and subscribing to IPOs.	Borrowing overnight funds, purchasing Treasury Bills and investing in Commercial Papers.

Functions of Capital Market

The capital market is an important part of the financial system that deals with the raising and lending of medium-term and long-term funds. It provides a platform for companies, government organisations and financial institutions to collect funds from investors through the issue and trading of financial securities such as shares, debentures and bonds.

The capital market performs several important functions in the economic development of a country. It helps mobilise savings, promote investment, encourage industrial growth and support capital formation.

Major Functions of Capital Market

1. Mobilisation of Savings

The capital market collects savings from individuals, households and various institutions. It encourages people to invest their surplus money in financial securities such as shares, bonds and debentures. These savings are converted into productive investments, which contribute to the economic development of the country.

2. Capital Formation

Capital formation is one of the major functions of the capital market. It helps businesses and industries raise long-term funds for establishing new projects, purchasing machinery, expanding production facilities and developing infrastructure. This increases the productive capacity of the economy.

3. Providing Long-Term Finance

The capital market provides long-term financial assistance to companies, industries and government organisations. Through the issue of shares, debentures and bonds, organisations can raise funds for business expansion, modernisation and development activities.

4. Encouragement of Investment

The capital market provides different investment opportunities to individuals and institutional investors. It encourages people to invest their savings in productive financial instruments rather than keeping their money idle. Investors can select securities according to their financial objectives, risk-taking capacity and investment period.

5. Promotes Industrial Development

The capital market supports the growth of industries by providing sufficient long-term financial resources. Companies can use the funds raised through the capital market to purchase advanced technology, establish new factories, improve production capacity and introduce new products. This helps promote industrial development.

6. Liquidity of Securities

The capital market provides liquidity to investors through secondary market transactions. Investors can buy and sell securities through recognised stock exchanges such as the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). This facility allows investors to convert their investments into cash whenever required, subject to market conditions.

7. Price Determination

The capital market helps determine the prices of securities through the forces of demand and supply. The prices of shares and other financial instruments change according to company performance, market conditions, investor expectations and economic developments. This helps establish fair market values for securities.

8. Economic Growth and Development

The capital market contributes to the overall economic growth of the country by providing financial resources for productive activities. It supports the development of industries, infrastructure, transportation, communication and other important sectors. These activities create employment opportunities and increase national income.

9. Efficient Allocation of Resources

The capital market helps transfer funds from individuals and institutions having surplus money to businesses and organisations requiring finance. It directs financial resources towards productive and profitable investment opportunities. This improves the efficient utilisation of available resources.

10. Encourages Entrepreneurship

The capital market provides financial support to entrepreneurs who want to establish new businesses or expand existing enterprises. By raising funds through shares, debentures and other securities, entrepreneurs can develop innovative products, introduce new technologies and create employment opportunities.

11. Risk Diversification

The capital market provides different types of financial securities with varying levels of risk and return. Investors can distribute their investments among equity shares, preference shares, government bonds and corporate bonds. This helps reduce investment risk through diversification.

12. Development of Financial Institutions

The capital market encourages the growth and development of financial institutions such as banks, mutual funds, insurance companies and investment companies. These institutions play an important role in collecting savings, providing financial services and promoting investment activities.

13. Protection of Investors

The capital market promotes investor protection through regulatory supervision and disclosure requirements. In India, the Securities and Exchange Board of India (SEBI) regulates the securities market and works to protect investors against unfair trade practices, fraud and market manipulation.

14. Promotes Government Development Activities

The capital market enables the government and eligible public sector organisations to raise long-term funds through government securities and bonds. These funds can be used for infrastructure projects, public transportation, education, healthcare and other development activities.

15. Promotes Corporate Governance

The capital market encourages companies to maintain transparency, accountability and proper financial reporting. Listed companies are required to follow applicable regulatory and disclosure requirements. This improves investor confidence and promotes responsible management practices.

Importance of Capital Market

The capital market is an important component of the financial system that provides a platform for raising and investing medium-term and long-term funds. It connects investors who have surplus money with companies, industries and government organisations that require funds for development and expansion.

The capital market plays a significant role in the economic development of a country by encouraging savings, promoting investment, supporting industrial growth and creating employment opportunities. It also helps in the proper utilisation of financial resources and strengthens the overall financial system.

Importance of Capital Market

1. Mobilisation of Public Savings

The capital market plays an important role in collecting savings from the public. It encourages individuals, households and institutions to invest their surplus funds in shares, bonds and debentures. These savings are converted into productive investments, which contribute to the economic development of the country.

2. Promotes Capital Formation

Capital formation is one of the major contributions of the capital market. It helps companies and industries raise long-term funds for purchasing machinery, establishing factories, expanding production facilities and developing infrastructure. This increases the productive capacity of the economy.

3. Provides Long-Term Financial Resources

The capital market provides long-term financial resources to business organisations, industries and government institutions. Companies can raise funds through the issue of equity shares, preference shares, debentures and bonds. These funds help organisations meet their long-term financial requirements.

4. Encourages Investment Opportunities

The capital market provides different investment opportunities to individuals and institutional investors. Investors can invest in equity shares, government securities, corporate bonds and other financial instruments according to their financial objectives and risk-taking capacity. It encourages people to invest their savings rather than keeping them idle.

5. Promotes Industrial Development

The capital market supports industrial development by providing sufficient financial resources to industries. Companies can use the funds raised to purchase modern machinery, introduce advanced technology, increase production capacity and establish new industrial units. This contributes to the growth of manufacturing and service sectors.

6. Creates Employment Opportunities

The capital market indirectly helps generate employment opportunities by providing financial support for business expansion and the establishment of new industries. When companies expand their operations, they require additional employees, which increases employment opportunities and improves the standard of living of people.

7. Encourages Economic Growth

The capital market contributes to the overall economic growth of the country. It provides funds for productive investment in industries, infrastructure, transportation, communication and other important sectors. These investments increase production, national income and economic development.

8. Provides Liquidity to Investors

The capital market provides liquidity through the buying and selling of securities in the secondary market. Investors can sell their shares, bonds and other securities through recognised stock exchanges such as NSE and BSE. This facility helps investors convert their investments into cash when required, subject to market conditions.

9. Efficient Allocation of Financial Resources

The capital market helps transfer funds from surplus units to deficit units. It directs financial resources towards companies and sectors that require funds for productive purposes. This ensures the efficient utilisation of available financial resources and reduces the wastage of savings.

10. Development of Entrepreneurship

The capital market encourages entrepreneurs to establish new businesses and expand existing enterprises. It provides opportunities to raise funds from investors through the issue of securities. This supports innovation, business development and the introduction of new products and services.

11. Promotes Foreign Investment

The capital market attracts foreign investment through permitted investment routes. Foreign investors can invest in Indian companies and financial securities subject to applicable regulations. Such investments bring additional financial resources, improve market development and strengthen the economy.

12. Helps in Price Determination

The capital market helps determine the prices of securities through the forces of demand and supply. The market price of shares and bonds changes according to company performance, investor expectations and economic conditions. This helps investors understand the market value of their investments.

13. Protection of Investors

The capital market provides investor protection through regulatory supervision and disclosure requirements. In India, the Securities and Exchange Board of India (SEBI) regulates the securities market and works to prevent fraudulent activities, unfair trading practices and market manipulation. This helps build confidence among investors.

14. Supports Government Development Activities

The capital market helps the government and eligible public sector organisations raise long-term funds through government securities and bonds. These funds can be utilised for infrastructure development, public transportation, education, healthcare and other public welfare activities.

15. Promotes Financial Stability

The capital market strengthens the financial system by providing an organised platform for raising and investing funds. Proper regulation, transparency and effective market operations help improve investor confidence and support the stability and development of the financial system.

Components of Capital Market

The capital market is an important part of the financial system that deals with the raising and lending of medium-term and long-term funds. It provides a platform for companies, government organisations and financial institutions to raise funds from investors through the issue and trading of financial securities such as shares, debentures and bonds.

The capital market consists of different components that help mobilise savings, provide investment opportunities and support the economic development of the country.

Major Components of Capital Market

The capital market is mainly divided into two major components:

Components of Capital Market



1. Primary Market (New Issue Market)

The primary market is an important component of the capital market where companies and government organisations issue new securities to raise funds directly from investors. It provides an opportunity for companies to collect long-term capital for business expansion, establishment of new projects, modernisation and other financial requirements.

In the primary market, securities are issued for the first time to investors. Companies can raise funds through Initial Public Offerings (IPO), Follow-on Public Offerings (FPO), rights issues and private placements. The funds collected are generally used for the development and growth of the organisation.

2. Secondary Market (Stock Exchange Market)

The secondary market is another important component of the capital market where existing securities are bought and sold among investors. In this market, investors can purchase or sell shares, bonds and debentures that have already been issued in the primary market.

The secondary market provides liquidity to investors by allowing them to convert their investments into cash whenever required, subject to market conditions. It also helps determine the market prices of securities through demand and supply. Stock exchanges such as the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) play an important role in the secondary market.

Other Important Components of Capital Market

Apart from the primary and secondary markets, the capital market also includes the following important elements.

3. Financial Institutions

Financial institutions play an important role in the development of the capital market by providing financial assistance and investment services. Institutions such as banks, insurance companies, mutual funds and development financial institutions help mobilise savings and provide funds for long-term investment activities.

4. Financial Instruments

Financial instruments are the securities through which companies and government organisations raise funds from investors. Important capital market instruments include equity shares, preference shares, debentures, corporate bonds and government securities.

5. Stock Exchanges

Stock exchanges provide an organised platform for buying and selling securities. They ensure transparency, liquidity and fair trading practices. In India, NSE and BSE are the major stock exchanges.

6. Investors

Investors are individuals and institutions that invest their surplus money in financial securities to earn returns. They include retail investors, institutional investors, mutual funds, insurance companies and foreign portfolio investors.

7. Financial Regulators

Financial regulators supervise and regulate capital market activities to protect investors and maintain transparency. In India, the Securities and Exchange Board of India (SEBI) is the principal regulator of the securities market.

Functions of Primary Market and Secondary Market

The capital market is mainly divided into two important components: the Primary Market (New Issue Market) and the Secondary Market (Stock Exchange Market). Both markets perform different functions in mobilising savings, raising capital, encouraging investments and promoting economic development.

Functions of Primary Market (New Issue Market)

The primary market is a financial market where new securities are issued and sold to investors for the first time. It helps companies, government organisations and other eligible institutions raise fresh capital to meet their long-term financial requirements. The funds collected through the primary market are used for business expansion, establishing new projects, purchasing machinery and other development activities.

Major Functions of Primary Market

1. Mobilisation of Savings

The primary market collects savings from individuals, households and institutional investors. It encourages people to invest their surplus money in newly issued shares, debentures and bonds. These savings are converted into productive investments, which contribute to economic development.

2. Raising Fresh Capital

One of the main functions of the primary market is to help companies raise fresh capital from investors. Companies issue new shares, debentures and bonds to collect funds for their business activities. This helps organisations meet their financial requirements without depending entirely on bank loans.

3. Encourages New Business Ventures

The primary market provides financial support to entrepreneurs who want to establish new businesses. By issuing securities to investors, companies can collect the required capital to start new projects, introduce innovative products and expand their business operations.

4. Promotes Industrial Development

The primary market supports industrial development by providing long-term funds to manufacturing and service industries. Companies can utilise the funds raised to purchase machinery, establish factories, adopt modern technology and increase production capacity.

5. Provides Investment Opportunities

The primary market offers different investment opportunities to individuals and institutional investors. Investors can subscribe to newly issued equity shares, preference shares, debentures and bonds according to their financial objectives and risk-taking capacity.

6. Supports Capital Formation

The primary market helps in capital formation by converting public savings into long-term productive investments. The funds collected by companies are used for purchasing fixed assets, developing infrastructure and expanding business operations.

7. Promotes Economic Growth

The primary market contributes to the economic growth of the country by providing funds for productive activities. It encourages industrial expansion, creates employment opportunities, increases production and improves the overall economic development of the nation.

8. Facilitates Government Fundraising

The primary market enables the government to raise long-term funds through the issue of government securities and bonds. These funds are used for infrastructure development, transportation, education, healthcare and other public welfare activities.

9. Encourages Public Participation

The primary market encourages the general public to participate in investment activities. Through public issues, individuals can become shareholders of companies and participate in their growth and development.

10. Reduces Dependence on Bank Finance

The primary market provides an alternative source of finance to companies. Instead of depending completely on bank loans, organisations can raise funds directly from investors through shares and debentures. This improves their financial flexibility.

Functions of Secondary Market (Stock Exchange Market)

The secondary market is a financial market where already issued securities are bought and sold among investors. It provides a platform for trading existing shares, debentures, bonds and other financial securities. Stock exchanges such as the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) play an important role in the functioning of the secondary market.

The secondary market helps investors convert their investments into cash, determines the market prices of securities and encourages continuous investment activities.

Major Functions of Secondary Market

1. Providing Liquidity

The secondary market provides liquidity to investors by allowing them to buy and sell existing securities whenever required, subject to market conditions. Investors can convert their investments into cash without waiting for the maturity of securities.

2. Price Determination

The secondary market helps determine the prices of securities through the forces of demand and supply. Share prices change according to company performance, market conditions, economic developments and investor expectations.

3. Facilitates Buying and Selling

The secondary market provides an organised platform for buying and selling existing securities. Investors can purchase shares from other investors and sell their securities through recognised stock exchanges.

4. Encourages Investment

The secondary market encourages individuals and institutions to invest in financial securities. The availability of a trading platform and the opportunity to sell securities increase investor confidence and participation in the financial market.

5. Provides Safety and Transparency

The secondary market operates under regulatory supervision and established trading procedures. In India, SEBI regulates the securities market and promotes fair trading practices, transparency and investor protection.

6. Mobilisation of Financial Resources

The secondary market encourages the circulation of financial resources among investors. Investors can transfer their funds from one security to another based on their investment objectives and market conditions. This improves the efficient utilisation of financial resources.

7. Provides Market Information

The secondary market provides information about share prices, trading volumes, market trends and company performance. This information helps investors make informed investment decisions.

8. Promotes Economic Development

The secondary market indirectly supports economic development by encouraging investment and improving confidence in the financial system. An active secondary market makes investors more willing to participate in new securities issues.

9. Facilitates Portfolio Diversification

The secondary market allows investors to purchase and sell different types of securities. Investors can diversify their portfolios by investing in shares of different companies and other financial instruments, helping them manage investment risks.

10. Acts as an Indicator of Economic Conditions

The performance of the secondary market reflects investor confidence and expectations about the economy. Changes in stock market indices such as NIFTY 50 and SENSEX provide useful information about market trends and economic conditions.

Difference Between Functions of Primary Market and Secondary Market

Basis	**Primary Market**	**Secondary Market**
1. Meaning	Deals with the issue of new securities.	Deals with the trading of existing securities.
2.Capital Formation	Helps companies raise fresh capital.	Does not directly provide fresh capital to issuing companies.
3. Main Function	Mobilises savings and raises funds.	Provides liquidity and facilitates trading.
4. Securities	New securities are issued.	Already issued securities are traded.
5. Price Determination	Issue price is determined through the applicable issue mechanism.	Market price is determined by demand and supply.
6. Participants	Issuing companies and investors.	Buyers and sellers of existing securities.
7. Funds Transfer	Funds generally go to the issuing organisation.	Funds generally go to the selling investor.
8. Investment Opportunities	Provides opportunities to invest in new securities.	Provides opportunities to trade existing securities.
9. Market Platform	Public issues, rights issues and private placements.	Stock exchanges such as NSE and BSE.
10. Liquidity	Does not itself provide continuous trading liquidity.	Provides liquidity through continuous trading.

Participants in the Capital Market

Participants in the capital market are individuals, institutions and organisations that take part in the buying, selling, issuing and regulating of long-term financial securities. They play an important role in mobilising savings, providing investment opportunities, raising capital and promoting economic development.

The capital market connects investors who have surplus funds with companies and government organisations that require long-term financial resources. Different participants perform different functions to ensure the smooth and efficient functioning of the capital market.

Major Participants in the Capital Market

1. Individual Investors

Individual investors are people who invest their personal savings in financial securities such as equity shares, preference shares, debentures and bonds. They invest money to earn dividends, interest income and capital appreciation. They play an important role in providing funds to companies and promoting investment activities.

2. Institutional Investors

Institutional investors are organisations that invest large amounts of money in different financial securities on behalf of their members or customers. They include mutual funds, insurance companies, pension funds and financial institutions. They help mobilise large amounts of savings and provide financial support to the capital market.

3. Companies and Corporate Organisations

Companies and corporate organisations participate in the capital market mainly to raise long-term funds for their business activities. They issue equity shares, preference shares, debentures and bonds to investors. The funds raised are used for business expansion, purchasing machinery, establishing new projects and modernising production facilities.

4. Government

The Central and State Governments participate in the capital market by issuing government securities and bonds to raise long-term funds. These funds are utilised for infrastructure development, public welfare programmes, transportation, education and other development activities.

5. Stock Exchanges

Stock exchanges provide an organised platform for buying and selling financial securities. They facilitate trading activities, ensure transparency and provide liquidity to investors. In India, the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are the major stock exchanges.

6. Securities and Exchange Board of India (SEBI)

SEBI is the principal regulatory authority of the Indian securities market. It regulates capital market activities and protects the interests of investors. It also supervises stock exchanges, intermediaries and listed companies to ensure fair trading practices, transparency and accountability.

7. Brokers and Sub-Brokers

Brokers act as intermediaries between buyers and sellers in the securities market. They help investors purchase and sell shares, bonds and other securities through stock exchanges. They also provide trading facilities and investment-related services to their clients. In India, stockbrokers are registered with SEBI and recognised stock exchanges.

8. Merchant Bankers

Merchant bankers provide financial advisory and investment banking services to companies that want to raise capital. They assist in IPOs, public issues, rights issues, underwriting arrangements and other corporate financial activities. They help companies complete the process of issuing securities in the capital market.

9. Mutual Funds

Mutual funds collect money from different investors and invest the collected funds in shares, bonds and other financial securities. They are managed by professional fund managers. They provide investors with opportunities for portfolio diversification and professional investment management.

10. Insurance Companies

Insurance companies collect premiums from policyholders and invest a portion of their funds in permitted financial securities. They invest in government bonds, corporate bonds and equity shares according to applicable regulations. Their investments contribute to the mobilisation of long-term financial resources.

11. Depositories

Depositories hold securities in electronic or dematerialised form on behalf of investors. They facilitate the transfer of securities and provide safe and efficient settlement services. In India, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are the two major depositories.

12. Foreign Portfolio Investors (FPIs)

Foreign Portfolio Investors are investors from outside India who invest in Indian financial securities such as shares, bonds and other permitted instruments. They bring foreign investment into the Indian capital market, improve market liquidity and contribute to the development of the financial system, subject to applicable regulations.

13. Underwriters

Underwriters are financial institutions or intermediaries that agree to subscribe to the securities that remain unsubscribed in an issue, subject to the underwriting agreement. They help companies raise the required capital and reduce the risk of an unsuccessful public issue.

14. Credit Rating Agencies

Credit rating agencies evaluate the creditworthiness of companies and financial instruments such as bonds and debentures. They assess the ability of an organisation to repay its debt obligations. Their ratings help investors understand the credit risk associated with different investment opportunities.

15. Clearing Corporations

Clearing corporations play an important role in the settlement of securities transactions. They ensure that securities are delivered to buyers and payments are received by sellers according to established settlement procedures. They reduce settlement risks and improve the efficiency of the capital market.

UNIT-IV

Role of Financial Institutions in the Financial System

1. Meaning of Financial Institutions

Financial institutions are organisations that provide various financial services such as accepting deposits, granting loans, providing investment facilities, insurance services and managing financial resources. They act as intermediaries between individuals and organisations that have surplus funds and those who require funds for different purposes.

Financial institutions play an important role in the development of the financial system by mobilising public savings, providing financial assistance, promoting investment and supporting economic growth. They help individuals, businesses, industries and government organisations meet their financial requirements.

In India, important financial institutions include the Reserve Bank of India (RBI), commercial banks, insurance companies, mutual funds, NABARD, SIDBI and other development financial institutions.

Role of Financial Institutions in the Financial System

1. Mobilisation of Savings

Financial institutions collect savings from individuals, households and business organisations through deposits, insurance policies and investment schemes. They encourage people to save money and provide different opportunities to invest their surplus funds. These collected savings are utilised for productive economic activities.

2. Providing Financial Assistance

Financial institutions provide financial assistance to individuals, businesses and industries in the form of loans and advances. They help entrepreneurs establish new businesses, companies expand their operations and individuals meet personal financial requirements. This improves business activities and economic development.

3. Promotion of Investment

Financial institutions encourage individuals and organisations to invest their money in different financial instruments such as shares, bonds, mutual funds and government securities. They provide investment guidance and financial services that help investors select suitable investment opportunities.

4. Capital Formation

Financial institutions contribute to capital formation by collecting savings and directing them towards productive investments. They provide long-term and short-term financial resources to industries, businesses and infrastructure projects. This increases the productive capacity of the economy.

5. Industrial Development

Financial institutions support industrial development by providing loans, financial assistance and investment facilities to manufacturing and service industries. Institutions such as SIDBI and other development finance organisations help small, medium and large industries meet their financial requirements.

6. Agricultural Development

Financial institutions play an important role in agricultural development by providing financial assistance to farmers and agricultural organisations. They offer loans for purchasing seeds, fertilisers, machinery, irrigation facilities and other agricultural requirements. NABARD plays an important role in supporting rural and agricultural finance in India.

7. Encouragement of Entrepreneurship

Financial institutions encourage entrepreneurship by providing loans, financial support and advisory services to new entrepreneurs. They help individuals start new businesses, develop innovative products and expand existing enterprises. This promotes self-employment and business development.

8. Risk Management

Financial institutions help individuals and organisations manage financial risks through insurance services, investment diversification and other risk-management facilities. Insurance companies provide protection against risks such as accidents, illness, property damage and business losses, according to policy terms.

9. Development of Rural Areas

Financial institutions support rural development by providing financial assistance to farmers, small businesses, self-help groups and rural entrepreneurs. They help improve rural infrastructure, agricultural activities and employment opportunities, contributing to balanced regional development.

10. Promotion of Foreign Trade

Financial institutions support international trade by providing export and import finance, foreign exchange services, letters of credit and other trade-related financial facilities. Institutions such as EXIM Bank of India play an important role in promoting India's foreign trade.

11. Employment Generation

Financial institutions indirectly create employment opportunities by providing finance to industries, businesses and entrepreneurs. When organisations receive financial support, they can establish new units, expand production and recruit additional employees. This helps reduce unemployment and improve living standards.

12. Financial Inclusion

Financial institutions promote financial inclusion by providing banking and financial services to weaker sections of society, rural populations and economically disadvantaged groups. They encourage access to savings accounts, credit facilities, insurance and digital payment services.

13. Maintaining Financial Stability

Financial institutions contribute to financial stability by following regulatory guidelines, maintaining adequate financial resources and managing risks effectively. The Reserve Bank of India supervises and regulates important banking activities to maintain confidence and stability in the financial system.

14. Development of Capital and Money Markets

Financial institutions help develop capital and money markets by participating in the issue, purchase and sale of financial instruments. They provide short-term and long-term funds and improve liquidity in financial markets. Their participation supports the efficient functioning of the financial system.

15. Promoting Digital Financial Services

Financial institutions encourage the use of digital banking, online transactions, mobile banking, internet banking and electronic payment systems. These services make financial transactions faster, easier and more convenient. They also improve transparency and accessibility of financial services.

Classifications of Financial Institutions

Financial institutions are organisations that provide financial services such as accepting deposits, granting loans, providing investment facilities, insurance services and managing financial resources. They act as intermediaries between individuals and organisations that have surplus funds and those who require funds for various financial activities.

Financial institutions play an important role in the economic development of a country by mobilising savings, providing financial assistance, promoting investment and supporting industrial and agricultural development.

Classification of Financial Institutions

Financial institutions can be classified into the following major categories:

Major Classifications of Financial Institutions

1. Banking Financial Institutions

Banking financial institutions are organisations that accept deposits from the public and provide loans and advances to individuals, businesses and industries. They play an important role in mobilising savings and supplying credit to different sectors of the economy.

Banking institutions help maintain liquidity, facilitate payment transactions and support economic development through their financial services.

Types of Banking Financial Institutions:

a) Central Bank

The central bank is the highest monetary authority of a country. In India, the Reserve Bank of India (RBI) is the central bank. It regulates the banking system, controls the supply of money, manages monetary policy and maintains financial stability.

b) Commercial Banks

Commercial banks accept deposits from the public and provide loans and advances to individuals, businesses and industries. They offer services such as savings accounts, current accounts, fixed deposits, ATM facilities and digital banking.

Examples: State Bank of India (SBI), HDFC Bank, ICICI Bank and Canara Bank.

c) Cooperative Banks

Cooperative banks are financial institutions established on cooperative principles to provide banking services to their members. They mainly support agriculture, small businesses and rural communities by offering loans and deposit facilities.

d) Regional Rural Banks (RRBs)

Regional Rural Banks are established to provide banking and credit facilities to rural populations, farmers, agricultural workers and small entrepreneurs. They help promote rural development and financial inclusion.

2. Non-Banking Financial Institutions (NBFIs)

Non-banking financial institutions are organisations that provide various financial services without functioning as traditional commercial banks. They provide financial assistance, investment facilities, insurance services and other financial products.

They play an important role in supporting economic activities and providing financial services to different sections of society.

Types of Non-Banking Financial Institutions:

a) Insurance Companies

Insurance companies provide financial protection against risks such as accidents, illness, death and property damage. They collect premiums from policyholders and provide compensation according to the terms and conditions of insurance policies.

Examples: Life Insurance Corporation of India (LIC), HDFC Life and ICICI Prudential Life Insurance.

b) Mutual Funds

Mutual funds collect money from different investors and invest the collected funds in shares, bonds, government securities and other financial instruments. They are managed by professional fund managers and provide investment opportunities to individuals.

Examples: SBI Mutual Fund, HDFC Mutual Fund and ICICI Prudential Mutual Fund.

c) Development Financial Institutions (DFIs)

Development financial institutions provide financial assistance for long-term development activities such as industrial growth, agricultural development, infrastructure development and small business development.

Examples:

- NABARD – Supports agriculture and rural development.
- SIDBI – Supports micro, small and medium enterprises.
- EXIM Bank – Promotes international trade.

- National Housing Bank (NHB) – Promotes housing finance.

d) Non-Banking Financial Companies (NBFCs)

NBFCs are financial companies that provide services such as loans, asset financing, investment activities and other financial services. They support individuals and businesses that require financial assistance.

Examples: Bajaj Finance, Shriram Finance and Mahindra Finance.

e) Pension Funds

Pension funds collect contributions from individuals and employers and invest them to provide financial benefits after retirement. They help individuals plan for their future financial security.

Example: National Pension System (NPS), regulated by PFRDA.

f) Microfinance Institutions

Microfinance institutions provide small loans and other financial services to low-income individuals, small entrepreneurs and self-help groups. They help promote self-employment, small businesses and financial inclusion.

Functions of Commercial Banks

Commercial banks are financial institutions that accept deposits from the public and provide loans and advances to individuals, businesses, industries and other organisations. They act as financial intermediaries between people who have surplus money and those who require funds for different purposes.

Commercial banks play an important role in the financial system by mobilising savings, providing credit facilities, facilitating payments and supporting economic development. They also provide various services such as money transfers, ATM facilities, internet banking, mobile banking and foreign exchange services.

Examples of commercial banks in India include State Bank of India (SBI), HDFC Bank, ICICI Bank, Canara Bank and Punjab National Bank (PNB).

2. Functions of Commercial Banks

The functions of commercial banks are broadly classified into three categories:

A. Primary Functions
B. Secondary Functions
C. Modern Functions

A. Primary Functions of Commercial Banks

1. Accepting Deposits

Accepting deposits is one of the most important functions of commercial banks. Banks collect money from the public and provide safety and interest on eligible deposits. They use these deposits to provide loans and advances to individuals and business organisations.

The major types of deposits are:

- Savings Deposits: These deposits are mainly designed for individuals who want to save money and earn interest on their savings.
- Current Deposits: These accounts are mainly maintained by business organisations to carry out frequent financial transactions.
- Fixed Deposits: Money is deposited for a specific period, and the bank pays interest according to the agreed terms.
- Recurring Deposits: Customers deposit a fixed amount regularly for a particular period and earn interest on their savings.

2. Granting Loans and Advances

Commercial banks provide loans and advances to individuals, businesses, industries and other organisations to meet their financial requirements. They provide financial assistance for purchasing houses, vehicles, machinery, raw materials and other business activities. Banks earn income through interest charged on loans.

3. Credit Creation

Credit creation is an important function of commercial banks. Banks create credit by lending a portion of the deposits received from customers while maintaining the required reserves. This process increases the availability of credit in the economy and supports business and economic activities. Credit creation is subject to RBI regulations and liquidity requirements.

4. Overdraft Facility

An overdraft is a facility provided by banks that allows customers to withdraw more money than the available balance in their accounts, up to an approved limit. It is generally provided to current account holders to meet temporary financial requirements. Interest is charged on the amount utilised according to the agreed terms.

5. Cash Credit Facility

Cash credit is a short-term borrowing facility provided mainly to business organisations. Banks allow businesses to borrow money up to a sanctioned limit against eligible security. It helps businesses meet their working capital requirements, purchase raw materials and manage daily operating expenses.

6. Discounting of Bills of Exchange

Commercial banks provide financial assistance by discounting bills of exchange before their maturity date. When a business receives a bill payable at a future date, it can approach the bank to receive money immediately after deducting the applicable discount charges. This helps businesses maintain sufficient working capital.

B. Secondary Functions of Commercial Banks

Secondary functions are additional services provided by commercial banks to customers. These functions are classified into agency functions and general utility functions.

I. Agency Functions

Agency functions refer to services performed by commercial banks on behalf of their customers.

1. Collection of Cheques and Bills

Banks collect cheques, bills of exchange and other financial instruments on behalf of their customers. The collected amount is credited to the customer's bank account after successful processing.

2. Payment of Insurance Premiums

Commercial banks help customers pay insurance premiums regularly through standing instructions or other available banking facilities. This reduces the burden of remembering payment dates.

3. Payment of Rent and Electricity Bills

Banks provide facilities to make regular payments such as house rent, electricity bills, telephone bills and other utility payments on behalf of customers.

4. Transfer of Funds

Commercial banks transfer money from one account to another within the same bank or to other banks. They provide services such as NEFT, RTGS and IMPS for convenient fund transfers.

5. Purchase and Sale of Securities

Banks may provide permitted investment-related services and execute transactions in securities on behalf of customers, subject to applicable regulations and authorisations.

6. Acting as Trustee and Executor

Commercial banks may act as trustees, executors and administrators of estates according to the applicable legal provisions. They help manage financial assets and carry out responsibilities on behalf of customers.

II. General Utility Functions

General utility functions refer to additional banking services provided for the convenience of customers.

1. Locker Facilities

Banks provide safe deposit locker facilities to customers for storing valuable items such as jewellery, important documents and other personal belongings.

2. ATM Facilities

Automated Teller Machines (ATMs) allow customers to withdraw cash, check account balances and perform other banking transactions without visiting a bank branch.

3. Debit and Credit Cards

Commercial banks issue debit and credit cards to customers. Debit cards allow customers to spend money from their bank accounts, while credit cards provide access to an approved credit limit.

4. Foreign Exchange Services

Banks provide foreign exchange services to individuals and businesses involved in international transactions. They facilitate currency conversion, foreign remittances and other permitted foreign exchange activities.

5. Banker's Cheque and Demand Draft

Commercial banks issue banker's cheques and demand drafts to facilitate secure payments and money transfers.

6. Providing Financial Information

Banks provide customers with financial information, account statements, interest details and other banking-related services. This helps customers manage their financial activities effectively.

C. Modern Functions of Commercial Banks

Modern commercial banks have introduced several technology-based services to make banking faster, easier and more convenient.

1. Internet Banking

Internet banking allows customers to access their bank accounts through websites. Customers can transfer funds, check balances, pay bills and download account statements without visiting bank branches.

2. Mobile Banking

Mobile banking enables customers to perform banking transactions through mobile applications. It provides facilities such as fund transfers, balance enquiries, bill payments and account management.

3. Digital Payment Services

Commercial banks provide digital payment facilities such as UPI, IMPS, NEFT and RTGS. These services allow customers to transfer money electronically in a convenient manner.

4. Financial Inclusion

Commercial banks promote financial inclusion by providing banking services to rural populations, low-income groups and economically weaker sections. They help people access savings accounts, credit facilities and digital payment services.

5. Online Loan Services

Modern banks provide online loan application and processing facilities. Customers can apply for personal loans, education loans, housing loans and business loans through digital platforms.

6. Customer Support Services

Commercial banks provide customer support through telephone banking, email, online chat and other digital communication channels. These services help customers resolve banking-related problems.

FUNCTIONS OF NON-BANKING FINANCIAL INSTITUTIONS (NBFIs)

Non-Banking Financial Institutions (NBFIs) are financial institutions that provide various financial services similar to banks but do not hold a full banking licence or perform all the functions of commercial banks. They play an important role in the Indian financial system by providing loans, credit facilities, investment services, insurance, leasing, hire purchase and other financial services to individuals, businesses and industries.

NBFIs help mobilise savings from the public and channel these funds into productive investments. They support economic development by providing financial assistance to sectors and individuals who may not have easy access to traditional banking services.

Examples in India: LIC, General Insurance Corporation, mutual funds, housing finance companies, non-banking financial companies (NBFCs), and other financial intermediaries.

Functions of Non-Banking Financial Institutions

1. Mobilisation of Savings

NBFIs collect savings from individuals, households and organisations through various financial products and investment schemes. They encourage people to save regularly and invest their surplus money in financial instruments. These collected funds are channelled into productive activities, thereby supporting economic development.

2. Providing Loans and Advances

One of the major functions of NBFIs is to provide loans and advances to individuals, small businesses, industries and other organisations. They offer different types of loans, such as personal loans, business loans, vehicle loans and housing loans. These credit facilities help borrowers meet their financial requirements and expand their economic activities.

3. Providing Investment Facilities

NBFIs provide different investment opportunities through mutual funds, insurance policies, bonds and other financial products. They help individuals invest their savings according to their financial goals and risk-taking capacity. These institutions also provide professional investment management services.

4. Promoting Industrial Development

NBFIs provide financial assistance to industries for purchasing machinery, purchasing raw materials, expanding production capacity and establishing new business units. They support both large-scale and small-scale industries by providing necessary financial resources. This helps increase industrial production and employment opportunities.

5. Providing Insurance Services

Insurance institutions protect individuals and businesses against financial losses arising from unexpected events. They offer life insurance, health insurance, motor insurance, property insurance and other insurance products. These services provide financial security and encourage long-term savings.

6. Providing Housing Finance

NBFIs provide financial assistance to individuals for purchasing, constructing and renovating houses. Housing finance institutions offer loans with different repayment periods and interest rates. These services help people fulfil their housing requirements and promote the development of the real estate and construction sectors.

7. Supporting Small and Medium Enterprises

NBFIs provide financial assistance to Micro, Small and Medium Enterprises (MSMEs) for starting, operating and expanding their businesses. They help small entrepreneurs obtain funds for machinery, equipment, working capital and business development. This encourages entrepreneurship and supports the growth of small businesses.

8. Leasing and Hire Purchase Facilities

NBFIs provide leasing and hire purchase facilities to individuals and business organisations. Under leasing, businesses can use machinery, vehicles and equipment by paying regular rental amounts instead of purchasing them immediately. Hire purchase allows customers to acquire assets through instalment payments, usually with ownership transferred after the agreed conditions are fulfilled.

9. Credit Creation and Credit Distribution

Certain NBFIs extend credit to individuals and businesses through loans and other financing arrangements. They distribute financial resources to different sectors of the economy according to their requirements. Unlike commercial banks, ordinary NBFIs generally do not create deposits in the same manner as banks.

10. Promoting Financial Inclusion

NBFIs provide financial services to people who may not have easy access to traditional banking facilities, particularly in rural and semi-urban areas. They offer microfinance, small loans, insurance and other financial products to economically weaker sections. This helps improve access to financial services and promotes inclusive economic growth.

11. Providing Microfinance Services

Microfinance institutions provide small loans and other financial services to low-income individuals, self-help groups and small entrepreneurs. These loans help people start small businesses, purchase equipment and generate income. Microfinance also supports women's entrepreneurship and rural development.

12. Risk Management and Financial Protection

NBFIs help individuals and organisations manage financial risks through insurance, investment diversification and other financial services. Insurance companies provide compensation for covered losses, while investment institutions help investors spread their investments across different financial instruments. These services reduce financial uncertainty and improve financial security.

13. Encouraging Capital Formation

NBFIs collect savings and direct them towards productive investments in industries, infrastructure, housing and other sectors. They help convert idle savings into productive capital. This process increases investment, improves production capacity and contributes to the overall economic development of the country.

14. Supporting Infrastructure Development

Financial institutions provide long-term financial assistance for infrastructure projects such as roads, electricity, transportation, communication and industrial development. Such financing supports the creation of essential facilities required for economic growth. It also helps improve public services and business opportunities.

15. Providing Financial Advisory Services

Some NBFIs offer financial planning, investment advice, portfolio management and wealth management services. They help customers understand different investment options and select suitable financial products based on their financial objectives. These services improve investment decisions and financial awareness.

16. Promoting Rural Development

NBFIs support rural development by providing credit facilities to farmers, small traders, rural entrepreneurs and self-help groups. They help finance agricultural equipment, small businesses and other income-generating activities. These services improve rural employment and contribute to balanced regional development.

17. Facilitating Economic Growth

NBFIs contribute to economic growth by providing finance to individuals, industries, businesses and infrastructure projects. Their financial services encourage investment, increase production, generate employment and improve the standard of living. Thus, they act as important intermediaries in the development of the economy.

UNIT-V

ROLE AND FUNCTIONS OF RBI (RESERVE BANK OF INDIA)

The Reserve Bank of India (RBI) is the central bank of India. It was established on 1st April 1935 under the Reserve Bank of India Act, 1934. It was nationalised on 1st January 1949. RBI is responsible for regulating the monetary and financial system of the country.

The main objective of RBI is to maintain monetary stability, control inflation, regulate the banking system, manage currency circulation and promote economic development. It acts as the banker to the government and the banker's bank in India.

Definition of RBI

The Reserve Bank of India is the central banking institution that regulates the issue of currency, controls the supply of money and credit, manages foreign exchange reserves and supervises the banking system of India.

Role of RBI in the Indian Financial System

1. Central Banking Authority

RBI acts as the central banking authority of India. It controls and supervises the country's monetary and banking system. It formulates monetary policies to maintain economic stability and ensure the smooth functioning of financial institutions.

2. Controller of Credit

RBI regulates the availability and cost of credit in the economy. It uses various monetary policy instruments to control the flow of money and credit. This helps to control inflation and maintain economic growth.

3. Currency Management

RBI has the responsibility of issuing and managing currency notes in India, except the one-rupee note and coins, which are issued by the Government of India. It ensures an adequate supply of clean and genuine currency notes.

4. Banker to the Government

RBI acts as a banker, agent and financial adviser to the Central and State Governments. It maintains government accounts, receives payments, makes payments and manages public debt on behalf of the government.

5. Banker to Banks

RBI acts as a banker's bank by maintaining cash reserves of commercial banks and providing financial assistance when required. It also guides and supervises commercial banks to maintain stability in the banking system.

6. Foreign Exchange Management

RBI manages India's foreign exchange reserves and regulates foreign exchange transactions under the Foreign Exchange Management Act (FEMA), 1999. It helps maintain stability in the value of the Indian rupee.

7. Economic Development

RBI supports the economic development of the country by encouraging financial inclusion, improving banking facilities and promoting credit availability to agriculture, small industries and other important sectors.

8. Financial Stability

RBI monitors the financial system and takes necessary steps to prevent banking crises. It supervises financial institutions and promotes confidence among depositors and investors.

Functions of RBI

The functions of the Reserve Bank of India can be classified into the following categories.

1. Monetary Policy Function

RBI formulates and implements monetary policy to regulate the supply of money and credit in the economy. It uses instruments such as repo rate, Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR) and open market operations to control inflation and maintain price stability.

2. Issue of Currency

RBI has the sole authority to issue banknotes in India, except the one-rupee note, which is issued by the Government of India. It ensures the availability of sufficient currency for business transactions and public requirements.

3. Regulation and Supervision of Banks

RBI regulates and supervises commercial banks, cooperative banks and other regulated financial institutions. It issues guidelines, grants banking licences and monitors banking operations to ensure the safety of the banking system.

4. Banker to the Government

RBI performs banking functions for both Central and State Governments. It maintains their accounts, manages government transactions, provides short-term financial assistance and manages the issue of government securities.

5. Banker to Banks

RBI maintains the cash reserves of scheduled commercial banks and provides financial support during emergencies. It also facilitates the settlement of transactions between banks.

6. Lender of Last Resort

RBI provides financial assistance to banks facing temporary liquidity shortages when they cannot obtain funds from other sources. This function helps prevent banking failures and maintains public confidence in the banking system.

7. Credit Control Function

RBI controls the volume and direction of credit in the economy. It uses quantitative and qualitative credit control methods to regulate lending activities and prevent excessive borrowing.

8. Foreign Exchange Management

RBI manages foreign exchange reserves and regulates foreign exchange transactions. It works towards maintaining orderly conditions in the foreign exchange market and stability in the external value of the Indian rupee.

9. Developmental Function

RBI promotes the development of the financial system by encouraging banking facilities in rural and backward areas. It supports priority sector lending, financial inclusion and the development of agricultural and small-scale industries.

10. Clearing House Function

RBI facilitates the clearing and settlement of payments between banks. It helps banks transfer funds smoothly and efficiently, reducing delays in financial transactions.

11. Collection and Publication of Data

RBI collects, analyses and publishes financial and economic information relating to banking, credit, inflation, money supply and foreign exchange. These reports help the government, researchers and financial institutions make informed decisions.

12. Consumer Protection Function

RBI protects the interests of bank customers by issuing guidelines on banking services, grievance redressal and fair banking practices. It also operates the Reserve Bank – Integrated Ombudsman Scheme to address eligible customer complaints.

ROLE AND FUNCTIONS OF SEBI (SECURITIES AND EXCHANGE BOARD OF INDIA)

The Securities and Exchange Board of India (SEBI) is the regulatory authority responsible for regulating and developing the securities market in India. It was established on 12th April 1988 and given statutory status on 30th January 1992 under the SEBI Act, 1992.

The main objective of SEBI is to protect the interests of investors, regulate the securities market and promote the development of the capital market in India. It supervises stock exchanges, brokers, mutual funds and other market intermediaries to ensure transparency, fairness and efficiency in securities transactions.

Definition of SEBI

SEBI is a statutory regulatory body established by the Government of India to protect investors, regulate the securities market and promote the orderly development of the securities market in India.

Role of SEBI in the Indian Financial System

1. Protection of Investors

SEBI plays an important role in protecting the interests of investors by ensuring fair and transparent dealings in the securities market. It creates awareness among investors about investment opportunities, risks and their rights. It also takes action against fraudulent activities and unfair trading practices.

2. Regulation of Securities Market

SEBI regulates the securities market by establishing rules and regulations for stock exchanges, brokers, merchant bankers and other market participants. It ensures that all market activities are conducted according to established laws and regulations.

3. Development of Capital Market

SEBI promotes the growth and development of the Indian capital market by introducing new policies, improving market infrastructure and encouraging investment activities. It helps companies raise funds through the issue of shares, debentures and other securities.

4. Prevention of Unfair Trade Practices

SEBI prevents fraudulent activities, insider trading, price manipulation and other unfair practices in the securities market. It takes strict action against individuals and organisations involved in such activities.

5. Promotion of Transparency

SEBI ensures that companies provide accurate and timely information to investors. It promotes transparency in financial reporting, stock exchange operations and securities transactions.

6. Regulation of Market Intermediaries

SEBI regulates intermediaries such as stockbrokers, merchant bankers, portfolio managers, mutual funds and investment advisers. It ensures that these intermediaries follow proper rules and maintain professional standards.

7. Investor Awareness and Education

SEBI conducts investor education programmes to improve financial literacy. It provides information about investment opportunities, market risks, investor rights and safe investment practices.

8. Promotion of Fair Competition

SEBI encourages fair competition among market participants by preventing monopolistic practices, market manipulation and misuse of confidential information. This helps maintain confidence in the capital market.

4. Functions of SEBI

The functions of SEBI are broadly classified into three categories:

Classification of SEBI Functions

A. Protective Functions :Protects investors and prevents unfair practices
B. Regulatory Functions:Regulates stock exchanges and market intermediaries
C. Developmental Functions:Promotes the growth of the securities market

A. Protective Functions of SEBI

Protective functions are concerned with protecting investors from fraudulent activities and unfair practices in the securities market.

1. Prevention of Insider Trading

SEBI prevents insider trading, which occurs when individuals use unpublished price-sensitive information to gain unfair profits by buying or selling securities.

2. Prevention of Price Manipulation

SEBI monitors stock market activities and takes action against individuals or organisations that artificially increase or decrease share prices.

3. Protection of Investors' Interests

SEBI safeguards investors against fraudulent schemes, misleading information and unfair business practices. It ensures that investors receive proper information before making investment decisions.

4. Promotion of Fair Trading Practices

SEBI ensures that securities transactions are conducted fairly and transparently. It prevents unfair advantages and promotes equal opportunities for all investors.

5. Investor Education

SEBI conducts awareness programmes, seminars and educational campaigns to help investors understand the securities market and investment risks.

B. Regulatory Functions of SEBI

Regulatory functions refer to the activities performed by SEBI to regulate and supervise the securities market.

1. Regulation of Stock Exchanges

SEBI regulates stock exchanges such as the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). It ensures that stock exchanges follow prescribed rules and maintain transparency in trading activities.

2. Registration of Intermediaries

SEBI registers and regulates various market intermediaries, including stockbrokers, merchant bankers, investment advisers, portfolio managers and mutual funds.

3. Regulation of Mutual Funds

SEBI establishes rules and regulations for mutual funds to ensure that they operate transparently and protect the interests of investors.

4. Regulation of Takeovers and Acquisitions

SEBI regulates the acquisition of shares and takeovers of listed companies. It ensures that such transactions are conducted fairly and that shareholders receive adequate information.

5. Inspection and Investigation

SEBI conducts inspections and investigations into the activities of stock exchanges, brokers and other market intermediaries to identify violations of securities laws.

6. Regulation of Public Issues

SEBI regulates the issue of shares, debentures and other securities by companies. It ensures that companies disclose relevant information to investors and follow prescribed procedures.

7. Enforcement of Securities Laws

SEBI takes necessary legal and administrative action against persons and organisations that violate securities market regulations.

C. Developmental Functions of SEBI

Developmental functions are concerned with improving the efficiency, growth and modernisation of the securities market.

1. Promotion of Capital Market

SEBI encourages the development of the capital market by introducing suitable policies and improving the functioning of securities markets.

2. Training of Market Intermediaries

SEBI promotes training and professional development programmes for brokers, investment advisers and other market participants to improve their knowledge and efficiency.

3. Introduction of New Financial Products

SEBI supports the development of new investment products and market instruments to provide investors with different investment opportunities.

4. Promotion of Online Trading

SEBI encourages electronic and online trading systems to make securities transactions faster, easier and more transparent.

5. Development of Market Infrastructure

SEBI promotes improvements in stock exchanges, depositories, clearing corporations and settlement systems to ensure efficient market operations.

6. Encouraging Institutional Investment

SEBI establishes regulatory frameworks for institutional investors to encourage investment and improve the availability of funds in the capital market.

7. Investor Awareness Programmes

SEBI organises financial literacy and investor awareness programmes to encourage informed participation in the securities market.

ROLE AND FUNCTIONS OF IRDAI IN THE INDIAN FINANCIAL SYSTEM

The Insurance Regulatory and Development Authority of India (IRDAI) is the regulatory body responsible for regulating, supervising and developing the insurance industry in India. It was established in 1999 under the Insurance Regulatory and Development Authority Act, 1999.

IRDAI plays an important role in maintaining the stability and efficiency of the insurance sector. It protects the interests of policyholders, regulates insurance companies and promotes the growth of the insurance industry in India.

It supervises both life insurance and general insurance companies and ensures that insurance services are provided in a fair, transparent and efficient manner.

IRDAI is a statutory regulatory authority established by the Government of India to protect the interests of policyholders and regulate, promote and ensure the orderly growth of the insurance industry in India.

Role of IRDAI in the Indian Financial System

1. Protection of Policyholders

IRDAI protects the interests of policyholders by ensuring that insurance companies follow fair business practices. It establishes guidelines regarding policy terms, premium payments, claim settlements and grievance redressal. This helps policyholders receive proper benefits and protection under their insurance policies.

2. Regulation of Insurance Companies

IRDAI regulates and supervises life insurance and general insurance companies operating in India. It grants registration to insurance companies and ensures that they follow prescribed rules and regulations. This helps maintain discipline and stability in the insurance sector.

3. Development of Insurance Industry

IRDAI encourages the development and expansion of the insurance industry by introducing suitable policies and regulations. It promotes insurance services in rural and urban areas and encourages insurance companies to develop new products according to customer requirements.

4. Promotion of Insurance Awareness

IRDAI promotes insurance awareness among the public by conducting educational programmes and providing information about different insurance products. It helps people understand the importance of life insurance, health insurance and general insurance.

5. Ensuring Financial Stability

IRDAI ensures that insurance companies maintain sufficient financial resources to meet their policyholder obligations. It monitors their financial performance and solvency position to protect the interests of policyholders.

6. Prevention of Unfair Practices

IRDAI prevents insurance companies and intermediaries from following unfair business practices. It monitors misleading advertisements, improper selling methods and unfair claim settlement practices to ensure transparency in the insurance industry.

7. Promotion of Competition

IRDAI encourages healthy competition among insurance companies. It allows companies to introduce innovative insurance products and improve customer services while following regulatory requirements.

8. Grievance Redressal

IRDAI promotes an effective grievance redressal system for policyholders. It ensures that insurance-related complaints are addressed through appropriate mechanisms and helps protect customers against unfair treatment.

4. Functions of IRDAI

The major functions of IRDAI are explained below.

1. Registration of Insurance Companies

IRDAI grants registration to insurance companies before they start insurance business in India. It ensures that only eligible and authorised companies operate in the insurance sector.

2. Protection of Policyholders' Interests

IRDAI protects policyholders in matters relating to insurance policy terms, nomination, assignment, claim settlement, surrender value and other policy-related services. It ensures that insurance companies follow fair and transparent practices.

3. Regulation of Insurance Agents and Intermediaries

IRDAI regulates insurance agents, brokers, corporate agents, surveyors and other insurance intermediaries. It establishes guidelines for their registration, professional conduct and activities.

4. Regulation of Insurance Premiums

IRDAI establishes regulatory guidelines relating to insurance products and premiums to ensure that insurance companies follow applicable rules and maintain fairness in their business operations.

5. Inspection and Investigation

IRDAI has the authority to inspect and investigate the activities, records and operations of insurance companies. It checks whether insurance companies comply with prescribed rules and regulations.

6. Promotion of Insurance Development

IRDAI promotes the growth of the insurance sector by encouraging innovation, introducing suitable regulatory reforms and improving insurance services throughout the country.

7. Control over Insurance Investments

IRDAI regulates the investment activities of insurance companies. It establishes investment guidelines to ensure that insurance funds are invested prudently and policyholders' money is protected.

8. Maintaining Solvency Margin

IRDAI ensures that insurance companies maintain the required solvency margin. This helps them meet future claims and financial obligations towards policyholders.

9. Regulation of Insurance Products

IRDAI regulates insurance products offered by insurance companies. It ensures that products comply with applicable regulations and provide appropriate information and protection to policyholders.

10. Settlement of Insurance Claims

IRDAI establishes guidelines relating to fair and timely claim settlement. It monitors insurance companies to ensure that genuine claims are processed according to applicable regulations.

11. Promotion of Rural and Social Insurance

IRDAI encourages insurance companies to extend insurance services to rural areas and economically weaker sections of society. It promotes wider insurance coverage and financial inclusion.

12. Regulation of Reinsurance Business

IRDAI regulates reinsurance activities in India. Reinsurance allows insurance companies to transfer a portion of their risks to other insurers, helping them manage large financial losses.

5. Objectives of IRDAI

i. To protect the interests of policyholders.
ii. To regulate insurance companies in India.
iii. To promote the orderly growth of the insurance industry.
iv. To ensure fair and transparent insurance practices.
v. To improve the quality of insurance services.
vi. To encourage competition among insurance companies.
vii. To promote insurance awareness among the public.
viii. To ensure financial stability of insurance companies.
ix. To expand insurance coverage in rural and social sectors.
x. To prevent fraudulent activities in the insurance industry.