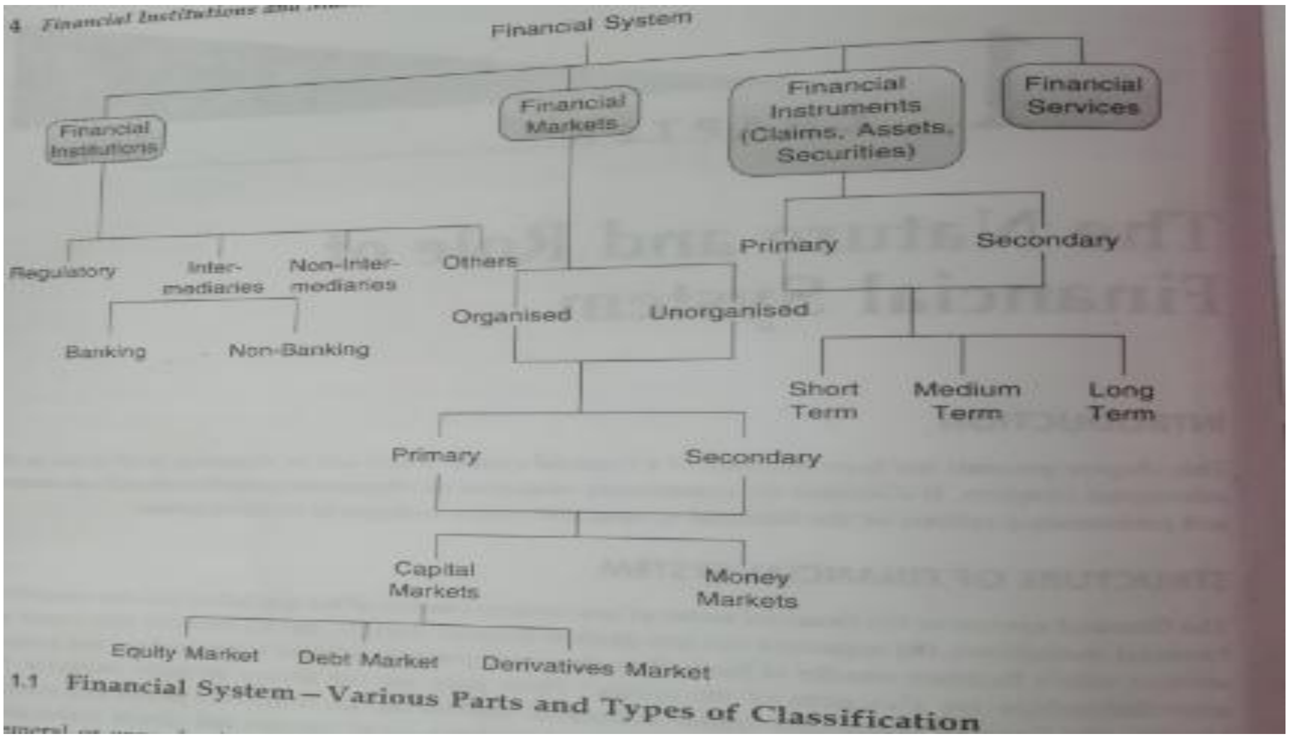
Structure of Indian Financial System

The financial system or the financial sector of any country consists of a) specialized and non specialized financial institutions, b) organized and unorganized financial markets and c) financial instruments and services which facilitate transfer of funds.

Figure: Structure of Financial System



1) Financial Institution:

A financial institution is an establishment that conducts financial transactions such as investments, loans and deposits. Almost everyone deals with financial institutions on a regular basis. The main classifications of financial institutions are

1. **Regulatory and Promotional Institutions:**

The two major regulatory and promotional Institutions in India are Reserve Bank of India (RBI) and Securities Exchange Board of India (SEBI).

2. **Banking Institutions:** Banking Institutions are the depositors and lenders of money. The basic three categories are

a) **Commercial Banks-** Their function is to act as depositors of public savings and function with profit motive. They accept deposits and lend them to those in need for a charge called interest which is their profit

b) **Cooperative Banks-** are a part of cooperative institutions which are based on principles of cooperation and mutual help. They accept deposits and lend short term and long term credit at reasonable rate of interest.

c) **Developmental Banks-** They are set up for the purpose of promoting certain sectors of the economy and cater to those only for, eg NABARD (National Bank for Agricultural and Rural Development) set up for providing agricultural credit and development of the rural sectors of the economy.

3. **Non-Banking Institutions:** These are small privately owned financial intermediaries which are engaged in accepting and disbursing funds. They are categorized in to different categories which are

   a. **Investment companies**- which provide loans for personal as well as commercial purpose and charge a high rate of interest as compared to banks.

   b. **Housing companies**-provide loans for the purpose of financial services related to development and construction of residential and commercial properties eg. ICICI Home Finance Ltd., LIC Housing Finance Co. Ltd…etc

   c. **Lease Financing-** A lease or tenancy is a contract that transfers the right to possess specific property. Leasing service includes the leasing of assets to other companies either on operating lease or finance lease.

   d. **Hire purchase (HP) Companies-** It is a type of asset finance that allows firms or individuals to possess and control an asset during an agreed term, while paying rent or installments covering depreciation of the asset, and interest to cover capital cost.

   e. **Specialised Financial Institutions-** They include Exim bank providing loan for export import,

   f. **Investment Institutions**- like Unit Trust of India (UTI) provide portfolio management services and Life Insurance Corporation providing cover for risk of loans of life.

   g. **State level Institutions-** They include State Financial Corporation (SFCs) provide credit within the state and State Industrial Development corporation(SIDCs) providing State Industrial Credit

11. Financial Markets:

It is a system through which funds are transferred from surplus sector to the deficit sector. On the basis of the duration of financial Assets and nature of product money market can be classified into 3 types:

a) **Money Markets:** These are the markets where securities having life of less than one year are traded.

b) **Capital Markets:** These are the markets where securities of life greater than one year are traded. . It also classified into two.

!)Primary (Direct) Market or New Issue Market

!!) Secondary Market

c) **FOREX Market:** It is a market where one currency is exchanged for another.

111) Financial Instruments:

It includes through these instruments financial Institution mobilise saving. These are of 2 type's i.e.

i) **Long Term:** Shares, Debenture, Mutual Funds, Term Loans.

ii) **Short Term:** Call Loan (money market), Promissory Notes, Bills of exchange etc.

IV) Financial services

Financial services include services like depository services, custodial functions, credit rating, leasing, portfolio management, under writing of shares and securities and the like.

Importance of Financial System in the Development of Indian Economy

The roles of financial system in economic development of a country are

1. **Savings-investment relationship:** To attain economic development, a country needs more investment and production. This can happen only when there is a facility for savings. As, such savings are channelized to productive resources in the form of investment. Here, the role of financial institutions is important.
2. **Financial systems help in growth of capital market:** Any business requires two types of capital namely, fixed capital and working capital. The capital market, money market along with foreign exchange market and government securities market enable businessmen, industrialists as well as governments to meet their credit requirements. In this way, the development of the economy is ensured by the financial system.

3. **Financial system helps in Infrastructure and Growth:** Economic development of any country depends on the infrastructure facility available in the country. The Development Banks and the Merchant banks help in raising capital for industries It is here that the financial services play a crucial role by providing funds for the growth of infrastructure industries.
4. **Financial system helps in development of trade:** The financial system helps in the promotion of both domestic and foreign trade. The best part of the financial system is that the seller or the buyers do not meet each other and the documents are negotiated through the bank. In this manner, the financial system not only helps the traders but also various financial institutions.
5. **Employment Growth is boosted by financial system:** The presence of financial system will generate more employment opportunities in the country. The money market which is a part of financial system provides working capital to the businessmen and manufacturers due to which production increases, resulting in generating more employment opportunities. The growth of trade in the country also induces employment opportunities.
6. **Financial system ensures Balanced growth:** Economic development requires a balanced growth which means growth in all the sectors simultaneously. Primary sector, secondary sector and tertiary sector require adequate funds for their growth.
7. **Financial system helps in fiscal discipline and control of economy:** The industries should be given suitable protection through the financial system so that their credit requirements will be met even during the difficult period. The government can also regulate the financial system through suitable legislation so that unwanted or speculative transactions could be avoided. The growth of black money could also be minimized.
8. **Financial system's role in balanced regional development:** Through the financial system, backward areas could be developed by providing various concessions.