

Financial System and Environment in India : An overview

A financial system is consisting of different financial assets, financial intermediaries, financial markets, borrowers and investors. An efficient financial system is of critical importance for the economic development of any country. Indian financial system is consisting of two sectors - the unorganized sector and the organized sector. The unorganized sector, scattered particularly in rural India, is outside the purview of the regulations and control of the government authorities. The organized sector, on the other hand, is consisting of different elements *i.e.*, the financial assets, financial intermediaries and financial markets and is well regulated by a network of government authorities.

Financial Market

A financial market may be defined as the market of financial assets *i.e.*, the market in which the financial assets are transacted. Issue of shares and debentures by a company, issue of mutual fund units, working capital loans by commercial banks, long-term financial assistance by financial institutions, inter-bank call money transactions are a few examples of financial transactions which are undertaken in financial markets. The financial market in India may be divided into different parts *i.e.*, the money market, the capital market, the foreign exchange market and the government securities market.

The **money market** is a term used to describe the market for short-term debt transactions. The money market in India consists of informal money market and formal money market. The informal money market includes the indigenous money lenders, *nidhis*, *chit funds*, *etc.*

Their operations are not governed by government regulations but by traditional practices. Usually their operations are restricted to a particular geographical area only. The basic characteristics of the informal money market are informal procedures, high rate of interest, flexible terms and loans as per mutual convenience of the parties, *etc.*

The formal money market is basically characterized by the presence of the Reserve Bank of India, Discount and Finance House of India Limited, Mutual Funds, Non-Banking Financial Companies, Commercial Banks, Financial Institutions, *etc.* These participants in the formal money market transact in Treasury Bills, Inter-Bank Call Money, Commercial Bills of Exchange, Inter-Corporate Deposits, *etc.* The basic characteristics of the formal money market are : (i) regulated by the RBI by way of regulation of interest rate and reserve requirements of Commercial Banks, (ii) fairly strict and rigid rules of operations, and (iii) low rate of interest.

The **capital market** is a market for long-term financial assets such as shares, bonds, debentures, mutual fund units, *etc.* It can be divided into New Issue Market (Primary market) and Secondary Market. The New Issue Market provides a system wherein different companies, mutual funds and institutions issues (sells) their financial instruments *e.g.*, shares, debentures, *etc.*, and the investors (both individuals and institutional) subscribe (buys) these instruments, The New Issue Market in India is well regulated by the Securities and Exchange Board of India (SEBI) which has issued guidelines for the issue of these instruments. The secondary market is the market in which the subsequent sale and purchase of these securities and instruments are undertaken. The secondary market is basically provided by the stock exchanges.

The **government securities market** is the market where the securities/loans of Central Government, State Governments and other Government authorities are traded. These securities, primarily in the form of government loans, are known as gilt-edged securities. The main participants in the government securities market are the commercial banks, provident funds, *etc.* Interest rates on these securities are low and there is virtually no secondary market for these securities.