

FINANCIAL MARKETS

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Introduction

- The economic development of any nation depends on the existence of a well organised financial system.
- The financial system is the one which supplies the necessary financial inputs for the production of goods & services which in turn promote the well being & living standard of a country.
- Thus, financial system is a border term which brings under the financial markets & financial institutions which support the system.
- These financial system provides the intermediation between savers & investors and promotes faster economic development.

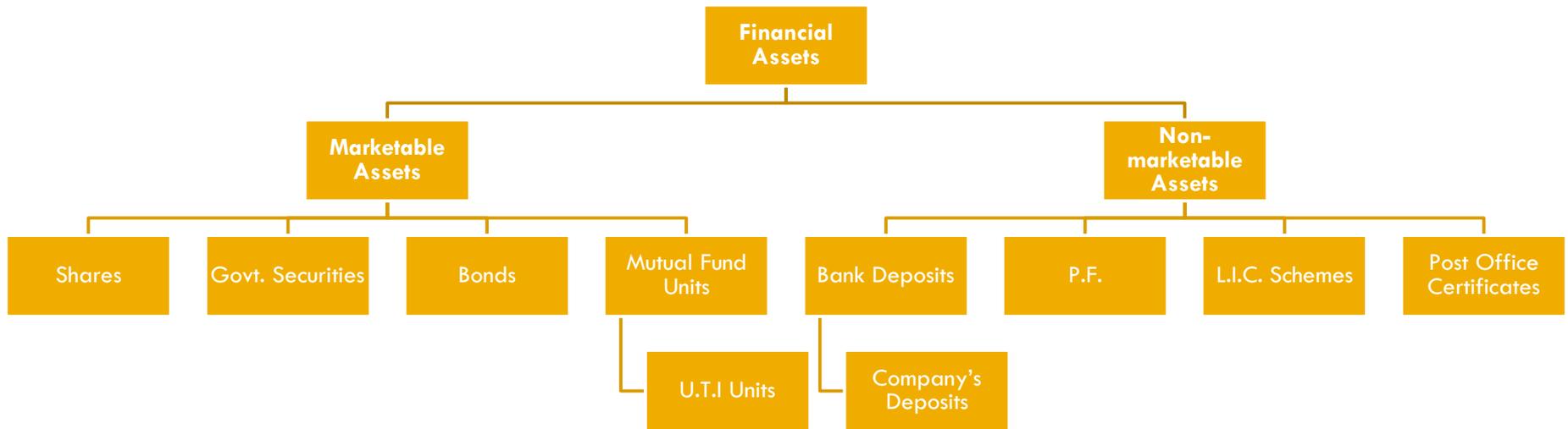
Functions of the financial system...

□ Broadly there are two key functions of financial system viz.,

1. Provision of liquidity.
2. Mobilization of savings.

Few Basic financial concepts...

Terminology	Description	Example
Financial Assets	...is the one which is used for production or consumption or for further creation of assets. Financial assets are of two types – marketable & non marketable assets.	For instance, if a person buys equity shares & these shares are financial assets since they earn income in future.
Marketable Asset	...are those which can be easily transferred from one person to another with out any obstacles	Share of listed companies, Government securities, Bonds of PSU etc.
Non-marketable Asset	... are those which can not be transferred easily.	Bank deposits, Provident funds, Pension funds, N.S.C., Insurance policies etc.

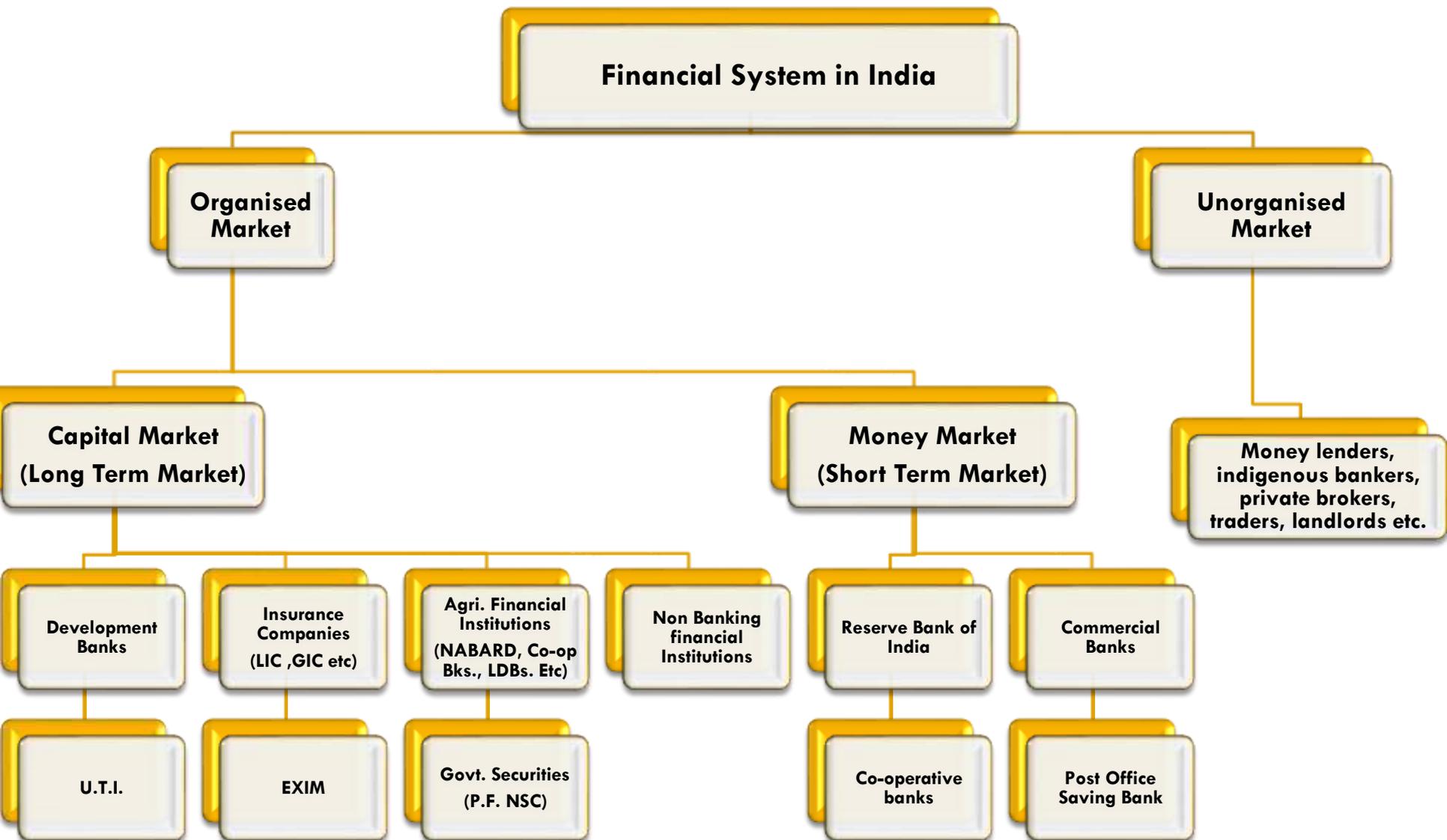


Concepts continue...

Terminology	Description	Example
Cash Asset	In India, all coins and currency notes are issued by R.B.I. & Ministry of Finance, G.o.I. Besides, Commercial banks create credit.	Coins, Currency notes, demand deposits etc.
Debt Asset	...is issued by various organizations for the purpose of raising the funds / capital. Fixed repayment schedule with principal and interest.	Issue of debentures, raising term loans, working capital advance etc.
Stock Asset	... it is issued by business organizations for the purpose of raising their fixed capital. Mainly of two types equity & preferential.	Equity shareholders are the real owners of business while preferential shareholders get a fixed rate of dividends and at the same time they retain some features of equity.

Concepts continue...

Terminology	Description	Example
Financial intermediaries	...includes all kinds of organizations & investing institutions which facilitate financial transactions in financial markets.	Capital market intermediaries & Money market intermediaries.
Capital market intermediaries	...mainly provides long term funds to individuals & corporates.	Development banks, Insurance companies, U.T.I., Govt. securities (P.F., NSC etc), Agri. Financial institutions, EXIM, NBFIs (Insurance co.s, Finance co.s. etc.)
Money market Intermediaries	...mainly supplies only short term funds to individuals & corporates.	R.B.I., Commercial banks, Co-operative banks, Govt. treasury bills etc.



Financial Markets

- Generally speaking, there is no specific place or location to indicate a financial market. Wherever a financial transaction takes place it is deemed to have taken place in the financial market.
- *Financial market can be referred to as those centre and arrangements which facilitate buying and selling of financial assets, claims and services.* In some cases transactions are taken place in particular location like stock market/stock exchange.

Financial Markets

- Definition:

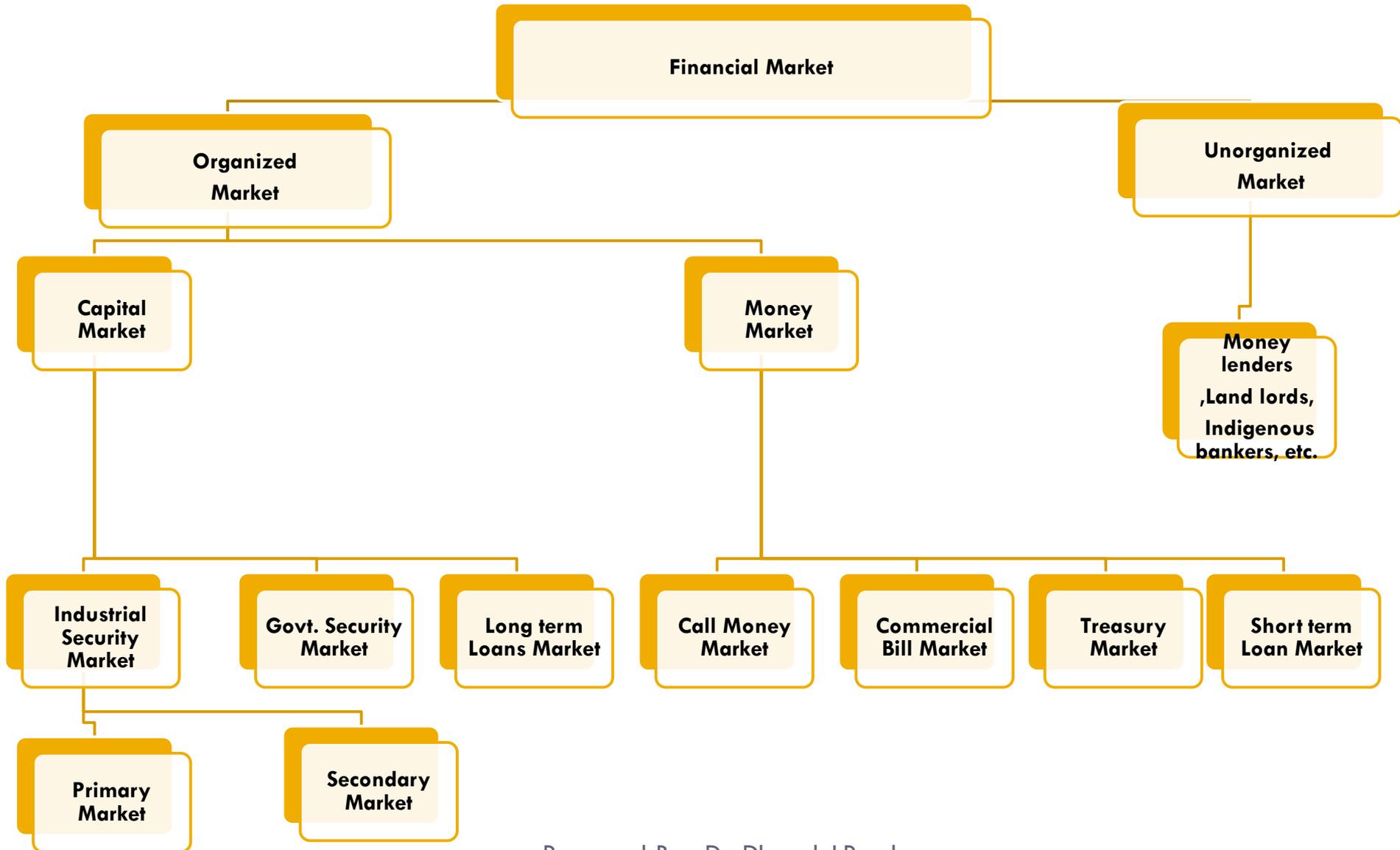
“The market of an economy where funds are transacted between the fund-surplus and fund-scarce individuals and groups is known as the financial market.”

Samuelson & Nordhaus, (2015), “Economics”, Tata McGraw Hill, USA, pp.543-545.

- The basis of transaction is either interest or dividend.

- This type of market might have its organized (institutionalized / regulated) as well as unorganized (non-institutionalized / unregulated) segments in an economy.

Classification of Financial Markets



Unorganized Market V/s. Organized Market

□ **Unorganized Market:**

- Before the Government started the organized development of organized market in India, its Unorganized market form had its presence since the ancient times.
- The activities under this form of market is not regulated. However, it is recognized by the Government. In recent times , some of them are included under regulated or organized market. (for example, the NBFCs were put under the regulatory control of the RBI in 1997).

Unorganized Market V/s. Organized Market

□ Organized Market:

- The organized market in India is just close to three & half decades old. It was the **Chakravarthy Committee** (1985) which , for the first time , underlined the need of an organized market in the country and the **Vaghul Committee** (1987) laid the blue print for its development.
- In organized markets, there are standardized rules and regulations governing financial dealings. There is high degree of Institutionalization and Instrumentatization. These markets are subject to strict supervision and control by RBI or other regulatory bodies like SEBI.

Organized Markets

- The organized market can be categorized in two parts –
 1. Capital Market
 2. Money Market

- Capital market: The long term financial market of an economy is known as capital market. It deals with long term securities which have a maturity period above one year.

- Money Market: This type of market is the short term financial market of an economy.

Indian Capital Market

- Across the world banks emerged as the first & foremost segment of the capital market. Over the period of time many other segments got added to it viz., insurance industry, mutual funds, & finally the most attractive & vibrant, security or stock market.
- It is believed today that for strong growth prospect in the economy presence of a strong & vibrant capital market is essential.
- For India, it is not so easy to develop its capital market. Various challenges were faced for raising the long term funds for industrial establishment & its expansion. To overcome such problems G.O. I. decided to set up 'financial institutions' which could play the role of banks & carry on responsibilities of project financing.

Significance of Capital Market

- It is an important source of productive use of economy's savings.
- It provides incentives to savings & facilitates capital formation.
- It provides an avenue for investors, particularly HH sector to invest in financial assets.
- It facilitates increase in production & productivity in the economy.
- It promotes stability in values of securities representing capital funds.
- It promotes economic growth.

Classification of Indian Capital Market

- Capital market may be classified in to three segments namely,-
 1. Industrial Security Market
 2. Government Security Market
 3. Long -Term Loans Market

Classification Conti...

Market	Description	Example
1. Industrial Security Market	...is the market where industries concern raise their capital or debt by issuing appropriate instruments.	<ol style="list-style-type: none">i. Equity / ordinary sharesii. Preference sharesiii. Debentures or bonds
(a) Primary Market	...is a market for new issues or new financial claims. It deals with those securities which are issued to the public for the first time.	<ol style="list-style-type: none">i. Public issuesii. Right issuesiii. Private placement
(b) Secondary Market	...is a market for secondary sale of securities. Usually such securities are quoted in the stock exchange & it provides a continuous & regular market for buying & selling of securities.	<ol style="list-style-type: none">i. Securities

Classification Conti...

Market	Description	Example
<p>2. Government Securities Market</p>	<p>...also called as Gilt-Edge Security Market. It is a market where short term & long term Government securities are traded.</p> <p>Securities issued by Central, State & Semi Govts., Port trust, State Electricity board, All India & State level Financial Institutions etc. are traded in such market.</p>	<ul style="list-style-type: none"> i. Stock Certificates / inscribed stock ii. Promissory notes iii. Bearer Bonds which can be discounted
<p>3. Long-Term Loans Market</p>	<p>In such kind of market Development Banks & Commercial Banks play important role in this market.</p>	<p>Loans provided by the financial institutions.</p>

Classification Conti...

Market	Description	Example
3. Long-Term Loans Market		
(a) Term loans market	In India many industrial financial institutions created by the Govt. both at national & regional levels to supply long term & medium term loans to corporates directly & indirectly.	IDBI, IFCI, ICICI etc.
(b) Mortgages Market	...refers to those market which supply mortgage loan mainly to individual customers. It is given against the securities of immovable property like real estate.	Housing & Urban Development Corporation-(HUDCO); LIC
(c) Financial Guarantees Market	...is a centre where finance is provided against a guarantee of a reputed person in the financial circle. The financial guarantees in India relate to – i. Deferred payments for X & M, ii. Medium & Long term loans raised abroad, iii. Loan advances by Banks & other financial institutions.	Export Credit Guarantee Corporation (ECGC) & Deposit Insurance & Credit Guarantee Corporation. (DICGC)

Project Financing

[A] Financial Institutions

[B] Banking Industry

[c] Insurance Industry

[D] Security Market

Project Financing - Financial Institutions

- The requirement of project financing made in India to go for a number of FIs from time to time , which are broadly classified in to four categories-

Level	Institutions	Year of Establishment
[i]All India Financial Institutions (AIFIs)	IFCI	1948
	ICICI	1955
	IDBI	1964
	SIDBI	1990
	IIBI	1997
	All India Development Bank	2000
[ii]Specialized Financial Institutions	Venture Capital funds	Late 1980s
	Tourism Finance Corporation of India	1989
[iii]Investment Institutions	LIC	1956
	UTI	1964
	GIC	1971
[iv]State Level Financial Corporation	SFCs	1955
	State Industrial Development Corp. (SIDC)	1960

Project Financing- Other Institutions

Category	Description
Banking Industry	In 1969 & 1980 the banking industry saw its nationalization. Again opening up of Private Sector Banks came into picture in 1993-94. At present, the industry consists of Commercial banks (public & private), RRBs & Co-operative Banks & Schedule Banks (171).
Insurance Industry	Various life & non-life insurance industry provides financial assistance to market after independence. The insurance industry was nationalized by the Government in 1956 & 1970 respectively.
Security Market	Today this market is considered as a very vibrant share market of the world & has challenged the monopoly of the banks in the capital market of the country.

Money Market

- Money market is a market for dealing with financial assets & securities which have a maturity period of up to one year. In other words, it is a market for purely short term funds.

- Money market is further subdivided into four heads-
 1. Call Money Market.
 2. Commercial Bills Market.
 3. Treasury Bills Market.
 4. Short Term Loan Market.

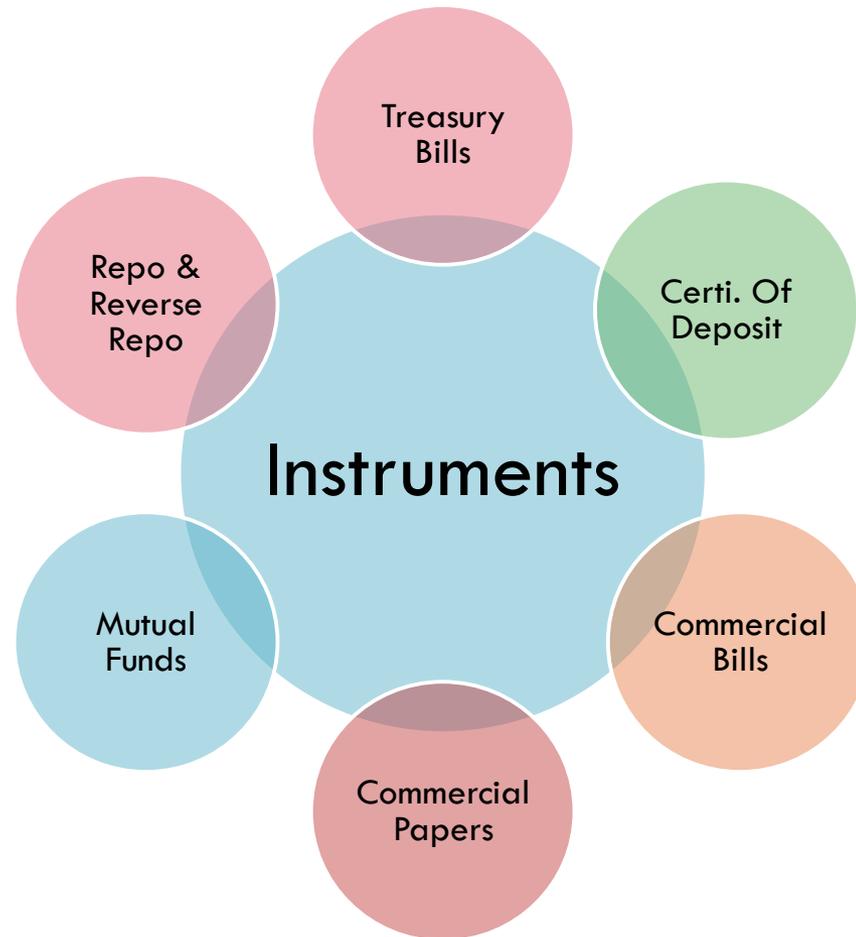
Types of Money Market

Money Market	Description
1. Call Money Market	It is a market for extremely short period loans say for 1 day to 14 days. It is highly liquid. The special feature of this market is the interest rate varies from day-to-day or from hour-to-hour & centre-to-centre.
2. Commercial Bill Market	It is a market for bills of exchange arising of genuine trade transactions. In case of credit sale, the seller may draw a bill of exchange on the buyer and buyer accepts such bill promising to pay at later date the amount specified in the bill.
3. Treasury Bill Market	It is a market for treasury bills which have 'short term maturity'. TB is a promissory note or financial bill issued by the Government. It is highly liquid because its repayment is guaranteed by the Government. Two types of TB viz., ordinary or regular & ad-hoc TBs.
4. Short Term Loan Market	It is a market where short term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play an important role by providing short term loans in the form of cash credit & overdraft in such market.

Objectives of Money Market

- It provides an equilibrium mechanism for ironing out short term surpluses & deficits.
- It provides a focal point for the intervention of the Central Bank for influencing liquidity in the economy.
- It provides access to user of short term money to meet their requirements at a reasonable price.

Money Market Instruments



Features of Money Market

- It is a market purely for short term funds or financial assets called near money.
- It deals with only those assets which can be converted readily.
- In such kind of market transactions take place through phones & transactions have to be conducted with out the help of brokers.
- It is not a single homogeneous market. It covers several sub-markets viz., call money market etc.
- The components of money market are Central Bank, Commercial Banks, NBFIs, Discount Houses, etc.

Characteristics of Developed Money Market

- Highly organized banking system.
- Presence of Central Bank.
- Availability of proper credit instruments.
- Existence of sub-markets.
- Ample resources.
- Existence of secondary market.
- Demand-supply of funds.

Characteristics of Indian Money Market (Deficiencies or Defects)

- ❑ Existence of unorganized sector.
- ❑ Absence of integration with banking system.
- ❑ Diversity in money rate of interest.
- ❑ Seasonal stringency of funds.
- ❑ Absence of bill market.
- ❑ No contact with foreign money markets.
- ❑ Limited instruments.
- ❑ Limited secondary market & participants.

Measures to improve Indian Money Market

- The activities of the indigenous banks should be brought under effective control of RBI.
- '*Hundies*' used in the market should be standardized & written in a uniform manner.
- Banking facilities should be expanded esp. in neglected areas.
- Discounting & rediscounting facilities should be expanded.
- Number of clearing houses in the country should be increased & their working too.
- Variation in the interest rates should be reduced.

Recent Developments...

- ❑ Integration of unorganized sector with organized sector.
- ❑ Widening of call money market.
- ❑ Introduction of Innovative instruments.
- ❑ Offering of market rate of interest.
- ❑ Promotion of bill culture.
- ❑ Entry of Money Market Mutual Funds. (MMMFs)
- ❑ Setting up of credit rating agencies like Credit Rating Information Services of India Limited (CRISIL); Credit Analysis & Research Limited (CARE); Investment Information & Credit Rating Agency of India (IICRA) etc.
- ❑ Adoption of suitable monetary policy.
- ❑ Establishment of The Discount & Finance House of India (DFHI).
- ❑ Setting up of Securities Trading Corporation of India Limited (STCI).

Financial Regulators

□ At present Indian Financial market has number of regulators, precisely 11 viz.,

1. Reserve Bank of India. (RBI)
2. Securities Exchange Board of India. (SEBI)
3. National Bank for Agriculture & Rural Development. (NABARD)
4. IRDA
5. Small Scale Industrial Development Bank of India. (SIDBI)
6. NHB
7. State Financial Corporations. (SFCs)
8. Industrial Development Bank of India. (IDBI)
9. FMC
10. CLB
11. Registrar of Co-operative Societies.

□ The **Narasimhan Committee** On Financial System (1991) has made a strong case for a single regulator for banks, financial institutions & for NBFIs. Prepared By : Dr. Dhaval J. Pandya

Banks & Financial Institutions

- Finance is the life blood of any economy. It is the finance which helps any industry to mobilize resources for organizing the production of various types of goods & services.
- It is the banks who provide the financial assistance to various businesses.
- Bank is a financial institution.

Types of Banks

Central Bank

Commercial Banks

Cooperative Bank

Specific Banks

(NABARD, IDBI, SIDBI, EXIM etc.)

Financial Institutions in India

Financial Institution in India

National Level	State Level	Institutions for Small Industries	Investment Institutions
1. IFCI 2. ICICI 3. IDBI 4. IRBI 5. SHCI 6. DFHI	1. SFCs	1. NSIC 2. SSIDCs 3. KVIC 4. SIDBI 5. Commercial banks	1. UTI 2. LIC 3. GIC 4. DIC

Financial Institutions

Institutions	Year of Establishment	Function/Objective
Industrial Finance Corporation of India (IFCI)	July,1948	To provide medium term & long term loans.
State Financial Corporation (SFC)	1953	To meet the requirements of medium & SSIs. At present there are 18 SFCs.
Industrial Credit & Investment Corporation of India (ICICI)	1955	To develop the industries under private sectors only.
State Industrial Development Corporation (SIDC)	1960	To achieve the rapid industrialization in the state. There are 28 SIDCs.
Industrial Development Bank of India (IDBI)	July,1964	To provide direct finance to various industrial units. It is an apex body in industrial sector & it's a subsidiary of RBI.

Financial Institutions

Institutions	Year of Establishment	Function/Objective
Export & Import Bank (EXIM)	1982	To provide financial assistance to exporters & importers.
National Bank for Agriculture & Rural Development (NABARD)	July,1988	To provide finance in agriculture sector & to promote research in agriculture & rural development. NABARD is an apex bank in agricultural sector.
Life Insurance Corporation of India (LIC)	1956	To protect the interest of policy holders & avoid the misuse of funds.
Unit Trust of India(UTI)	1964	To encourage & mobilize the savings of community.
General Insurance Corporation (GIC)	1972	

Thank You

For quires feel free to contact...

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