

Financial System and Working of Financial Markets in India



Rachit Saini

E-mail: rachit.saini.1@gmail.com

Abstract

The financial system plays a critical role in the economy of any country by facilitating the flow of funds between savers and investors. The financial system in India comprises various institutions, including banks, non-banking financial companies, and the Reserve Bank of India. The money market and capital market are two crucial segments of the financial system that provide short-term and long-term financing options, respectively. The Reserve Bank of India plays a pivotal role in regulating the financial system, implementing monetary policies, and maintaining financial stability in the country. Scheduled banks, including commercial banks, regional rural banks, and cooperative banks, are responsible for meeting the credit requirements of various sectors of the economy. The capital market provides businesses and governments with long-term financing options through the issuance of securities such as stocks and bonds. The efficiency and stability of the financial system have a significant impact on the financial markets and influence the availability of capital, liquidity, investor confidence, and market regulation. This paper provides an introduction and overview of the financial system and financial markets in India. It discusses the structure of the money market, the banking structure in India, the role of the Reserve Bank of India, and the structure of the capital market. The paper also examines the impact of the financial system on the financial markets in India, including the availability of capital, liquidity, investor confidence, regulation, and technology. The financial system and financial markets in India have come a long way, and the government and regulatory authorities have taken several measures to improve their efficiency and stability. The development of the financial system and financial markets is critical for the growth of the Indian economy, and continued efforts are required to maintain their sound functioning.

Introduction

India's financial system is a complex network of institutions, markets, and intermediaries that facilitate the transfer of funds between savers and borrowers. The system includes various types of financial institutions, such as banks, insurance companies, mutual funds, and stock exchanges. The financial markets in India are regulated by the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI). The working of financial markets in India involves the interaction between buyers and sellers of financial instruments, such as stocks, bonds, currencies, and derivatives. These financial instruments are traded in different types of financial markets, such as the stock market, bond market, commodity market, and currency market. The working of these markets is regulated by various regulatory bodies and government agencies.

The Indian financial system has undergone significant reforms over the past few decades to make it more efficient, transparent, and globally competitive. One of the key reforms was the liberalization of the financial sector in the 1990s, which led to the entry of private players in the banking and insurance sectors. This increased competition has led to the development of innovative financial products and services, which have made the financial system more accessible and inclusive.

The Indian financial system has also adopted various measures to promote financial inclusion and literacy, such as the Pradhan Mantri Jan Dhan Yojana, which aims to provide access to basic banking services to all households in the country. The system has also implemented various technology-driven initiatives, such as the Unified Payments Interface (UPI) and Bharat Bill

Payment System (BBPS), to promote digital payments and reduce the use of cash.

Overall, the Indian financial system has come a long way in terms of its development and efficiency. However, there are still several challenges that need to be addressed, such as the need to strengthen the regulatory framework, enhance financial literacy, and promote financial stability.

Structure of Money Market

The money market is a segment of the financial market where short-term financial instruments are traded. The money market serves as a platform for the borrowing and lending of funds for a period of up to one year. The following are the key components of the structure of the money market:

- **Participants:** The participants in the money market include commercial banks, the Reserve Bank of India (RBI), financial institutions, mutual funds, and corporate treasuries. These entities participate in the money market as borrowers, lenders, or both.
- **Instruments:** The instruments traded in the money market include Treasury Bills, Certificates of Deposit, Commercial Papers, Repurchase Agreements, and Call Money. These instruments are short-term in nature and have a maturity period of up to one year.
- **Intermediaries:** The intermediaries in the money market include Primary Dealers, who are authorized by the RBI to trade in government securities, and Money Market Mutual Funds, which invest in short-term money market instruments on behalf of investors.
- **Market Infrastructure:** The money market infrastructure includes the Clearing Corporation of India Limited (CCIL), which provides a platform for the settlement of trades in money market instruments, and the Negotiated Dealing System-Order Matching (NDS-OM), which is an electronic trading platform used by the RBI to conduct auctions of Treasury Bills.

- **Regulation:** The money market is regulated by the Reserve Bank of India (RBI), which sets the policy rates, conducts auctions of government securities, and provides liquidity support to the market when necessary.

Overall, the structure of the money market is designed to facilitate the efficient borrowing and lending of funds in the short-term, while ensuring transparency and stability in the market.

Banking Structure in India

The banking structure in India is a tiered system that includes various types of banks and financial institutions. The following is a brief overview of the different types of banks and their functions:

- **Reserve Bank of India (RBI):** The RBI is the central bank of India and is responsible for regulating the monetary policy of the country. It also acts as a banker to the government and supervises the functioning of other banks in the country.
- **Public Sector Banks:** Public sector banks are banks that are owned and controlled by the government of India. These banks include State Bank of India (SBI) and its subsidiaries, as well as other banks like Punjab National Bank (PNB), Bank of Baroda (BOB), and Canara Bank. These banks play a crucial role in the development of the economy by providing credit to various sectors.
- **Private Sector Banks:** Private sector banks are banks that are owned and controlled by private individuals or companies. These banks include ICICI Bank, HDFC Bank, and Axis Bank, among others. These banks have played a significant role in the development of the banking sector by introducing innovative products and services.
- **Foreign Banks:** Foreign banks are banks that are headquartered outside India but operate in the country. These banks include Standard Chartered Bank, Citibank, and HSBC, among others. These banks provide services to both retail and corporate customers.

- **Co-operative Banks:** Co-operative banks are banks that are owned and controlled by their members, who are usually people from the same locality or profession. These banks play a crucial role in providing credit to small and medium-sized enterprises (SMEs) and farmers.

Overall, the banking structure in India is designed to promote financial stability and provide access to credit to various sectors of the economy. The Reserve Bank of India plays a crucial role in regulating the functioning of banks and ensuring the stability of the banking system.

Reserve Bank of India

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

The primary functions of the RBI are:

- **Regulating the monetary policy:** The RBI is responsible for formulating and implementing monetary policy in India. It sets the benchmark interest rates, such as the repo rate, to regulate the money supply in the economy.
- **Regulating the banking system:** The RBI is the regulator of the banking system in India. It issues licenses to banks and regulates their functioning, including their lending practices, capital adequacy, and liquidity ratios.
- **Managing foreign exchange reserves:** The RBI manages India's foreign exchange reserves, which are used to ensure the stability of the rupee against other currencies.
- **Issuing currency:** The RBI is responsible for issuing and managing the currency in circulation in India.
- **Promoting financial inclusion:** The RBI is responsible for promoting financial inclusion and ensuring that banking services are available to all sections of society.
- **Conducting research and analysis:** The RBI conducts research and analysis

on various aspects of the economy and publishes reports on issues such as inflation, banking, and monetary policy.

Overall, the RBI plays a crucial role in maintaining the stability of the financial system in India and promoting the growth of the economy.

Reserve Bank of India

The Reserve Bank of India (RBI) is the central bank of India, established in 1935 under the Reserve Bank of India Act, 1934. The RBI is responsible for formulating and implementing monetary policy, regulating and supervising the banking system, managing foreign exchange reserves, and promoting financial inclusion in the country.

Some of the key functions of the RBI are:

1. **Monetary Policy:** The RBI formulates and implements monetary policy in India to regulate the supply of money and credit in the economy, and control inflation. It sets the policy rates such as the repo rate, reverse repo rate, and cash reserve ratio (CRR), which have a direct impact on interest rates and the cost of borrowing for banks and businesses.
2. **Banking Regulation and Supervision:** The RBI regulates and supervises banks and financial institutions operating in India to maintain financial stability and ensure that they follow prudential norms such as capital adequacy, asset quality, and liquidity. It issues banking licenses, monitors compliance with regulations, and intervenes when necessary to resolve issues such as non-performing assets (NPAs) or bank failures.
3. **Foreign Exchange Management:** The RBI manages India's foreign exchange reserves, which are used to maintain the stability of the rupee in the international market. It intervenes in the foreign exchange market to buy or sell dollars to maintain a stable exchange rate, and also formulates policies to promote exports and manage capital flows.
4. **Currency Management:** The RBI is responsible for issuing and managing currency in circulation in the country. It

ensures the availability of cash in the economy, manages the supply of new currency notes, and monitors counterfeit currency.

5. **Developmental Role:** The RBI plays a developmental role in the economy by promoting financial inclusion, supporting the growth of small and medium-sized enterprises (SMEs), and facilitating the adoption of digital payments and financial technologies.

Overall, the RBI is a key institution in the Indian financial system and plays a crucial role in maintaining financial stability and promoting economic growth.

Scheduled Banks in India

Scheduled banks in India are banks that are listed in the Second Schedule of the Reserve Bank of India Act, 1934. These banks are eligible for loans from the RBI at the bank rate and are subject to the provisions of the Banking Regulation Act, 1949.

Scheduled banks in India can be classified into two categories:

1. **Commercial Banks:** Commercial banks are banks that provide services to individuals, businesses, and other organizations. They accept deposits, lend money, and offer a range of financial products and services. Commercial banks can further be classified into:
 - **Public Sector Banks (PSBs):** PSBs are banks that are owned and controlled by the government of India. Examples include State Bank of India, Bank of Baroda, and Punjab National Bank.
 - **Private Sector Banks:** Private sector banks are banks that are owned and controlled by private individuals or companies. Examples include ICICI Bank, HDFC Bank, and Axis Bank.
 - **Foreign Banks:** Foreign banks are banks that are headquartered outside India but have branches or subsidiaries in India. Examples include Citibank, Standard Chartered Bank, and HSBC.
 - **Co-operative Banks:** Co-operative banks are banks that are owned and

controlled by their members, who are usually people from the same locality or profession. They provide credit to small and medium-sized enterprises (SMEs) and farmers. Co-operative banks can further be classified into:

- **Urban Co-operative Banks (UCBs):** UCBs are co-operative banks that operate in urban and semi-urban areas. They are regulated by the RBI and are registered under the Cooperative Societies Act.
- **State Co-operative Banks (SCBs):** SCBs are co-operative banks that operate at the state level. They are registered under the State Co-operative Societies Act and are regulated by the RBI.
- **District Central Co-operative Banks (DCCBs):** DCCBs are co-operative banks that operate at the district level. They are registered under the State Co-operative Societies Act and are regulated by the RBI and the respective State Governments.

Overall, scheduled banks play a crucial role in the Indian financial system and provide credit and financial services to individuals, businesses, and other organizations. The RBI regulates and supervises these banks to maintain financial stability and promote economic growth.

Structure of Capital Market

The capital market is a segment of the financial market where long-term financial instruments such as stocks, bonds, and other securities are traded. The primary function of the capital market is to channel savings and investment capital to businesses, governments, and other entities that need funds for long-term investment purposes.

The structure of the capital market can be divided into two segments:

1. **Primary Market:** The primary market is the segment of the capital market where newly issued securities are sold for the first time by issuers to raise long-term capital. This market is also known as the new issue market. In the primary market, companies and governments raise funds

by issuing securities such as shares, bonds, debentures, and other debt instruments. The primary market facilitates the transfer of savings from investors to companies or governments that require capital for investment.

2. **Secondary Market:** The secondary market is the segment of the capital market where already issued securities are traded among investors. This market is also known as the stock market. The secondary market provides liquidity to investors by allowing them to buy or sell securities at market prices. Investors can buy and sell securities in the secondary market through stock exchanges such as the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The secondary market also provides a platform for companies to raise additional capital by issuing securities through follow-on public offers.

The structure of the capital market also includes various participants such as:

1. **Investors:** Investors are individuals, institutions, or organizations that invest their savings in securities to earn returns. Investors can be classified into retail investors and institutional investors such as mutual funds, insurance companies, and pension funds.
2. **Intermediaries:** Intermediaries are entities that facilitate trading in securities in the primary and secondary markets. They include investment banks, brokers, and dealers who help issuers in the primary market and provide liquidity and trading platforms in the secondary market.
3. **Regulators:** Regulators are entities that oversee the functioning of the capital market and ensure that the market operates in a fair and transparent manner. In India, the Securities and Exchange Board of India (SEBI) is the regulatory body that oversees the capital market.

The structure of the capital market plays a vital role in channeling savings to investment and

providing liquidity to investors. The capital market facilitates economic growth by enabling companies and governments to raise long-term capital for investment purposes.

Impact of Financial system on Financial Market in India

The financial system in India has a significant impact on the financial markets in the country. Here are some of the key ways in which the financial system affects the financial market:

1. **Availability of Capital:** The financial system plays a critical role in providing capital to businesses and other entities. The availability of capital has a significant impact on the financial markets, as it affects the supply and demand for securities. If the financial system is functioning efficiently, it will be easier for companies to raise capital, which will increase the supply of securities in the market. This will, in turn, increase competition among buyers, leading to a more efficient pricing of securities.
2. **Liquidity:** The liquidity of the financial system has a significant impact on the financial markets. A liquid financial system means that investors can easily buy and sell securities, which increases the efficiency of the market. On the other hand, an illiquid financial system can lead to a lack of investor confidence and reduce the demand for securities, leading to a fall in prices.
3. **Investor Confidence:** The stability and efficiency of the financial system have a significant impact on investor confidence. If investors have confidence in the financial system, they are more likely to invest in securities, which increases demand and prices. However, if investors lose confidence in the financial system, they may withdraw their investments, leading to a fall in prices.
4. **Regulation:** The regulation of the financial system has a significant impact on the financial markets. Effective regulation can increase investor

confidence and reduce the risk of fraud and misconduct, leading to a more efficient market. On the other hand, ineffective regulation can lead to market manipulation, fraud, and other unethical practices, which can harm investors and reduce market efficiency.

5. **Technology:** The adoption of new technologies in the financial system has a significant impact on the financial markets. The use of technology can improve the efficiency of the financial system, increase access to capital, and reduce transaction costs. For example, the use of online trading platforms has made it easier for investors to buy and sell securities, increasing market efficiency.

The financial system in India has a significant impact on the financial markets. A well-functioning financial system can increase the availability of capital, increase liquidity, improve investor confidence, and reduce market risk. On the other hand, an inefficient or unstable financial system can harm investor confidence, reduce demand for securities, and lead to a fall in prices.

Conclusion

In conclusion, the financial system in India plays a crucial role in the economy by facilitating the flow of funds between savers and investors. It comprises a range of institutions, including banks, non-banking financial companies, and the Reserve Bank of India. The money market and capital market are two key segments of the financial system that provide short-term and long-term financing options, respectively.

The Reserve Bank of India plays a pivotal role in regulating the financial system, implementing monetary policies, and maintaining financial stability in the country. Scheduled banks, including commercial banks, regional rural banks, and cooperative banks, form the backbone of the Indian banking system and are responsible for meeting the credit requirements of various sectors of the economy.

The capital market provides businesses and governments with long-term financing options through the issuance of securities such as stocks and bonds. The efficiency and stability of the

financial system have a significant impact on the financial markets and influence the availability of capital, liquidity, investor confidence, and market regulation.

Overall, the financial system and financial markets in India have come a long way, and the government and regulatory authorities have taken several measures to improve their efficiency and stability. The development of the financial system and financial markets is critical for the growth of the Indian economy, and continued efforts are required to maintain their sound functioning.

References

1. Reserve Bank of India. (2022). About Us. Retrieved from <https://www.rbi.org.in/Scripts/AboutUsDisplay.aspx>
2. Ministry of Finance. (2022). Indian Financial System Code (IFSC). Retrieved from <https://www.finmin.nic.in/indian-financial-system-code-ifsc>
3. National Stock Exchange of India Limited. (2022). Capital Market. Retrieved from <https://www.nseindia.com/products-services/equity/capital-market>
4. Securities and Exchange Board of India. (2022). About SEBI. Retrieved from <https://www.sebi.gov.in/about-sebi.html>
5. Reserve Bank of India. (2022). Money Market. Retrieved from https://www.rbi.org.in/Scripts/MSM_Market.aspx
6. Reserve Bank of India. (2022). Scheduled Commercial Banks. Retrieved from <https://www.rbi.org.in/Scripts/AboutUsDisplay.aspx?pg=ScheduledCommercialBanks.htm>
7. Securities and Exchange Board of India. (2022). Capital Market. Retrieved from <https://www.sebi.gov.in/sebiweb/home/Capital-Market.html>
8. Ministry of Finance. (2022). Non-Banking Financial Companies. Retrieved from <https://www.finmin.nic.in/non-banking-financial-companies-nbfc>

International Journal of Professional Development

Vol.11,No.1, Jan-June.2022

ISSN: 2277-517X (Print), 2279-0659 (Online)

9. Reserve Bank of India. (2022). Regional Rural Banks. Retrieved from https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=9544
10. Securities and Exchange Board of India. (2022). Market Regulations. Retrieved from <https://www.sebi.gov.in/sebiweb/home/Market-Regulation.html>

www.ijpd.co.in