Role and Functioning of Indian Financial System: An Evaluation and Its Importance in Indian Economy

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Abstract

The financial development of a country is reflected by the advancement of the different monetary units, comprehensively arranged into corporate part, government and family unit segment. There are zones or individuals with surplus assets and there are those with a shortage. A monetary framework or financial division capacities as a go-between and encourages the progression of assets from the zones of surplus to the regions of deficiency. A Financial System is a structure of different organizations, markets, guidelines and laws, practices, money director, investigators, exchanges and cases and liabilities.

Introduction:

The Concept of the Financial System

The procedure of savings, finance and investment involves financial institutions, markets, instruments and facility. Supervision control and guidelines are equally important. So, Financial or economical management is an essential part of financial system. In the basis of some proofs, Goldsmith said that" A study of a theory that separation of the functions of savings and investment which made feasible by the base financial instruments as well as growth of the range of financial assets which also rise the potential of investments and increase the ratio of formation of capital to production and financial actions and from these two channels the rate of development increase."

Inter-relationship in the Financial System

A financial system is system that offers various services that are required in the modern economy. The utilization of stable, broadly accepted medium of exchange that decreases the price of transaction. It increase trade and also focuses in production. Financial assets with engaging yield, liquidity and risk characterize inspire saving in financial form. By estimating different investments and monitoring the actions of borrowers, financial mediators increase the efficiency of utilization of resource. Approach to a diversity of financial institution allows an economic agent to pool, price and

risks of exchange in the capital market. Trade is the well planned use of resource; saving and risk taking are the foundation of growing economy. The country could make this attainable with the assist of the financial system. The economic model has been worked as an agent who helps in the growth and development of the economy by making it one of the important inputs of growth.

Indian Financial System

Financial framework involves set of subsystems of financial organizations, monetary markets, monetary instruments and administrations which helps in the development of capital. It gives a system by which reserve funds are changed to speculation. "System", in the expression "financial framework", infers a lot of complex and firmly associated or interlinked foundations, specialists, rehearses, markets, exchanges, cases, and liabilities in the economy. The monetary framework is worried about money, credit and fund - the three terms are personally related at this point are to some degree not quite the same as one another. Indian financial framework comprises of monetary market, financial instruments and financial intermediation

The Indian financial framework can be comprehensively arranged into the formal (sorted out) monetary framework and the casual (disorderly) financial framework. The formal financial framework goes under the domain of the Ministry of Finance (MOF) Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and other administrative bodies. The casual monetary framework comprises of:

- Individual money banks, for example, neighbors, family members, land masters, merchants, storekeepers, etc.
- Groups of people working as assets or 'affiliations'. These gatherings work under their very own arrangement rules.
- Partnership firms comprising of nearby specialists, pawn agents and non-banking financial middle people, for example, account, venture, and chit subsidize organizations.

In India the spread of banking in provincial zones has helped in amplifying the extent of the formal financial framework.

Structure of Indian financial system

Financial structure refers to shape, components and their order in the financial system. The Indian financial system can be broadly classified into formal (organised) financial system and the informal (unorganised) financial system. The formal financial system comprises of Ministry of Finance, RBI, SEBI and other regulatory bodies. The informal financial system consists of individual money lenders, groups of persons operating as funds or associations, partnership firms consisting of local brokers, pawn brokers, and non-banking financial intermediaries such as finance, investment and chit fund companies. The formal financial system comprises financial institutions, financial markets,

financial instruments and financial services. These constituents or components of Indian financial system may be briefly discussed as below:

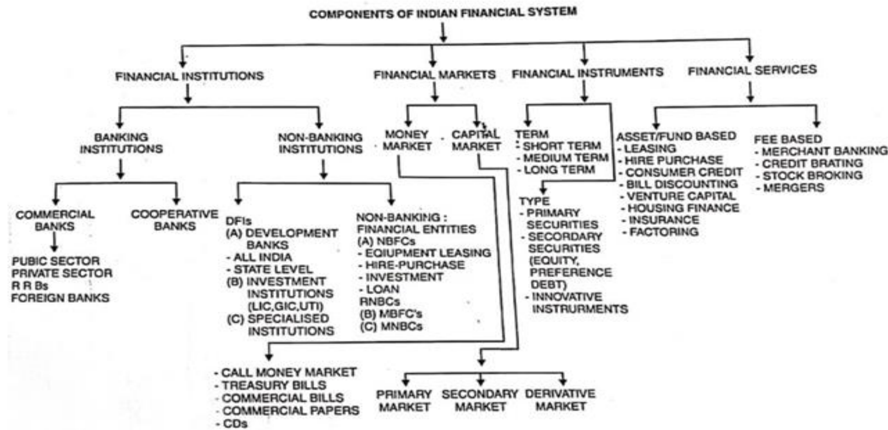

Figure 1.1: Components of Indian financial system

Financial Institutions

Financial institutions are the participants in a financial market. They are business organizations dealing in financial resources. They collect resources by accepting deposits from individuals and institutions and lend them to trade, industry and others. They buy and sell financial instruments. They generate financial instruments as well. They deal in financial assets. They accept deposits, grant loans and invest in securities.

The institutions discussed include: (a) institutions in the banking sector, (b) development financial institutions, (c) investment institutions, (d) mutual funds and (e) non-banking financial companies.

Financial Markets

The financial system of a country works through the financial markets and the financial institutions. The financial markets deal with the financial assets of different types, currency deposits, cheques, bills, bonds, etc.

Financial markets perform the following functions:

1. To facilitate creation and allocation of credit and liquidity.
2. To serve as intermediaries for mobilisation of savings.
3. To help in the process of balanced economic growth.
4. To provide financial convenience.

5. To provide information and facilitate transactions at low cost.
6. To cater to the various credits needs of the business organisations.

Financial markets are credit markets which cater the credit needs of individuals, firms and institutions. Since credit is required and supplied for short period and long period, the financial markets are broadly divided into two types: (a) money market and (b) capital market. from 1000 to about 3000 during 1980-81 to 1991-92

Financial Instruments

The financial assets or near-money assets are the claims to money and perform some functions of money. They have high degree of liquidity but are not as liquid as money is. Financial assets are of two types: (a) primary or direct assets, and (b) secondary or indirect assets. Primary assets are the financial claims against real-sector units created by real-sector units as ultimate borrowers for raising funds to finance their deficit spending; they are the obligations of ultimate borrowers.

The examples of Primary assets are bills, bonds, equities, book debits, etc. Secondary assets are financial claims issued by financial institutions against themselves to raise funds from the public; these assets are the obligations of the financial institutions.

Growth and Development of Indian Financial System

At the time of independence in 1947, there was no strong financial institutional mechanism in the country. The industrial sector had no access to the savings of the community. The capital market was primitive and shy. The private and unorganised sector played an important role in the provision of liquidity. On the whole, there were chaos and confusions in the financial system.

After independence, the government adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and social objective. The government started creating new financial institutions to supply finance both for agricultural and industrial development. It also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction.

Functions of financial system

Saving: Both people and organizations the same put aside money in the present to have more to spend later on. People normally spare during their working years so they can pull back money later on to subsidize their retirement. Partnerships may set aside money gathered from clients to reimburse providers or moneylenders, buy new hardware, or to procure different organizations.

1. **Borrowing:** rather than saving, getting includes accepting money in the current that will be reimbursed later on. Individuals can acquire money through made sure about advances, as most vehicle advances and home loans for instance, where the bank can sell the benefit posted as security if the borrower defaults

2. **Raising Equity Capital:** Companies use venture banks to help with raising value capital, where financial specialists exchange money for a portion of possession in the organization.
3. **Managing Risks:** In request to manage risks, financial specialists use forward agreements, fates contracts, alternatives contracts, protection contracts, and different subsidiaries.
4. **Exchanging Assets for Immediate Delivery (Spot Market Trading):** People and organizations utilize the spot market to exchange money to get different monetary forms or products, which will be conveyed promptly when the exchange happens.
5. **Information Motivated Trading:** While the two investors and data motivated brokers eventually attempt to purchase low and sell high, data motivated dealers are distinctive in that they hope to acquire overabundance comes back from their educational favorable position notwithstanding the ordinary returns conventional financial specialists gain for the danger of holding a benefit after some time.
6. **Deciding Appropriate Rates of Return:** Since savers are on the furthest edge of exchanges with borrowers and value dealers, the pace of return must be set at where the two players are fulfilled.
7. **Efficient Capital Allocation:** Efficient capital portion permits the market's scant capital to be dispensed to just the most gainful investments. A market is effective when advertise members approach exact data. At the point when investors are intensive in their investigation of accessible data, they improve the proficiency of the market by essentially acting in their own eventual benefits.

Role and Importance 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 saving-investment 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).

Objective of Study:

- Discussion of source and progress of financial system in our country through the course.

- Emphasizing the suggestions of different committees and commissions regarding financial sector.
- Evaluation of relation between economic growth and financial development along with the evaluation causality between the both in our country.

Literature Review

1. Goyal and Joshi (2012) analyze in his study "Indian Banking Industry": Difficulties and opportunities" That the Indian Banking Industry has a enormous shade of history, which comprises the traditional banking rehearsal from the time of Britishers to the improvements period of time, nationalization to privatization of banks and now at present time, the number of foreign banks are increasing in India. Therefore, there have been long runs of Banking of India.
2. In 1984 and 1988, Murthy and Jadhav respectively stated that From 1980s, many changes took place in Indian Financial market. As the new and modern instruments of savings introduced in markets, there was a consistent decrement in the rate of banks savings. So it could be said that reduction in the financial use between producers and consumers was already in place for the first half of 1980s it outcomes to 33% declination in bank savings in 1981-82 from 53 % in 1980-81.
3. Banerji, Sanjay and Basu Parantap (2009) examine that associative performance of whole combined financial system with respect to a standalone system where there is severe deattachment between depositeries and underwritten activities where both system are in danger to difficulties of moral hazard.
4. Subramanian and Swami (1994) in their paper, Comparative execution of public division banks in India" Prjanan, Vol. XXII, have broken down and analyzed the proficiency in six open segment banks, four private segment and three unfamiliar banks for the year 1996-97.
5. Demirgüç-Kunt and Levine (1996) conducted a study by using information from both factories and developing nations. Their views assist the Gurley and Shaw (1955) that at low levels of developmental corporate banks are the preceding financial institution. As gradually economies growing, intermediaries of specific financial institution and equity markets develop and expand, which will decrease the share or part of banking finance in the overall economical system

Conclusion

We have discussed in this chapter different aspects of the Indian financial system as a prelude to the proper understanding of the financial scandal of 1992. The Indian financial system consists of a vast network of institutions with the Ministry ofFinance occupying the apex position. Ofthe financial institutions, the banking sector occupies the prime position with nearly 87 per cent of the total

deposits being controlled and managed by public sector banks. During the 1980s, new financial institutions were established and a number of new financial instruments came into the market. There was also considerable development in the money market, capital market and the government securities market. However, along with the developments in the financial institutions, instruments and markets, there was no corresponding development in the regulatory system. This made the entire financial system especially the banking system and stock exchanges over regulated and under-governed. Such a financial system was naturally susceptible to manipulations by unscrupulous players in the market.

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