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Indian Financial System and Capital Market an Overview

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Abstract: Financial activities in the world are fast changing and the borders are widening beyond imagination. The early form of banking, say, the goldsmith banking, took leap to present day online banking. In the changing scenario, the definition of banking is also to be revised thoroughly and to be either shortened or widened to suit the present day circumstance. Capital Market, on a wider range, is primarily of two types – primary market and secondary market. As the very names suggest, primary market is there to subscribe to the IPOs or direct public offers made by the companies from time to time by issuing shares or other instruments of finance. This is, in other words, direct subscription to the capital/ instrument issues. Secondary market is a reference, colloquially speaking, to the second hand market i.e., purchase and sale of shares other than by direct subscription. Stock markets, stock exchanges and other media come under this fold

Key words: Indian financial system, Financial Sector, capital markets, Securities market

Introduction

When we study the origin and growth of financial institutions across the globe, we are surprised only the rapid growth of these institutions in a short time. Even the definition of banking also requires to be thoroughly revised and redefined to suit the present day scenario. When Mohammed-bin-Tughlak (a Muslim rules of India, who was considered a freak of creation by virtue of his personal talents, foresight vision and virtues, but equally ridiculed for his peculiar experiments) visualised the forthcoming paucity of metals, and also the decreasing worth of currency and increasing worth of metals, beyond one's imagination, he introduced *leather coins* or *leather currency*. Then he was criticised and was depicted as mad Tughlak by historians. Generally precious metals were replaced by base metals. Even these base metals were later replaced by paper, which is very much in vogue. Banking which has witnessed several changes from the days of Goldsmith's receipts to the present age of 'Swift' banking further replaced even the bundles of paper with cheques, drafts, etc. With the advancement of technology, it evolved further as plastic currency replaced all other currencies across the globe. Using a simple plastic card with a black stripe or chip, millions of financial transactions can be made across the globe. In the financial system, these are transferred either directly or indirectly. The Indian financial system comprises specialised and non-specialised financial institutions; organised and unorganised financial markets; financial instruments and financial services; banking and non-banking institutions; and Mutual Funds and Capital Markets. (See figure 1.1).

The close relationship between financial structure and economic development is reflected in the prevailing institutional arrangement, delivery system and intermediation process (Sadhak, H., 1997). Financial institutions are also business organisations that act as mobilisers and depositories of savings, and as purveyors of credit or finance. Besides, financial institutions provide

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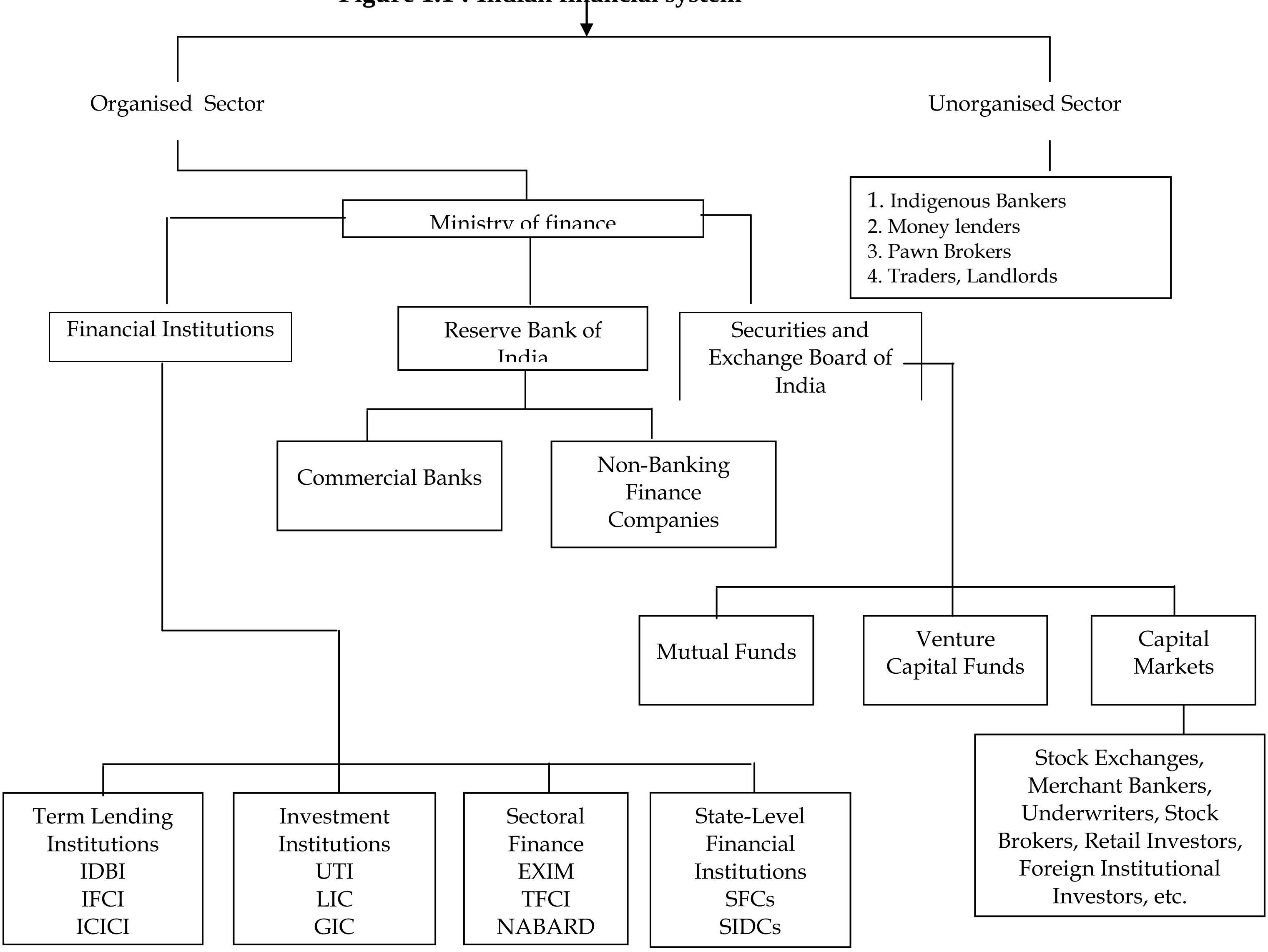
various financial services. The activities of different financial institutions may be either specialised or, quite often, they may overlap. Yet, we need to categorise financial institutions on the basis of main activity, the degree of their specialisation, the manner of their creation and so on. Besides functional, geographical, sectoral and other factors, scopes of activity, type of ownership etc. are often taken into consideration while making classification. According to one classification, financial institutions are divided into banking and non-banking ones. Though non-banking institutions have a few points of similarities with banking institutions, the distinguishing character lies in the acceptance of deposits and rendering other services by the banks.

Figure 1.1 : Indian financial system



Even the definitions of banking by the Statute, and also by the veterans across the globe make the banks distinct from similar institutions. Banking institutions are creators of credit and money whereas non-banking institutions are suppliers and circulators of money or equivalents. On the other

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hand, the regulatory and controlling mechanisms of bank are also quite different from those of NBFCs.

Banking system in India consists of commercial banks and co-operative banks. Some of the traditionally well known non-banking financial institutions of India are Life Insurance Corporation of India (LIC), Unit Trust of India (UTI), Industrial Development Bank of India (IDBI) etc. But now the purview of the NBFCs is so exhaustive that large hire purchasing and leasing companies entered the fray and made their arena vast even challenging the stake of commercial banks in certain instances. If we observe the recent trends in the financial market, banks – MNC banks and private sector banks and new entrants in the financial market in particular – are arranging road shows for marketing their products. Right from vehicular finance to the financing of heavy construction machinery, cranes and ships the NBFCs have been increasing their share in the market and posing a challenging to the banks.

Financial Institutions are also categorised as intermediaries and non-intermediaries. As intermediaries, the institutions act as bridge between the suppliers of money and demanders of money. They pool the savings of the people drop by drop and create a financial ocean under various schemes of deposits and make the funds available – subject to the statutory provisions and stipulations of RBI and other controlling bodies – to the borrowers. In a nutshell, they are the catalysts of financial demand and supply. Non-intermediary institutions carry out lending business but the resources are directly obtained from different sources. Non-intermediary institutions mainly comprise IDBI, IFCI, and NABARD. These institutions came into existence by virtue of separate statutes to provide indirect assistance through commercial banks for specific purposes, sectors, regions etc. They are created to cater to the needs of specialised borrowers to enable them to seek the required funds through organisations, by providing refinance and other facilities to such bodies or organisations.

Since they have been set up by the Government, they are referred to as Non-banking Statutory Financial Institutions (NBSFIs). Guerley and Show (1955)[i] view the role of financial institutions as one of helping realise the opportunities for savings and real investment in an economy. Mobilisation of funds and their creation took a different part, i.e., a shift from self-financing to direct financing and then to indirect financing, in which the (i) Commercial banks, (ii) Insurance and others, and (iii) Finance companies are suppliers of indirect financing.

All these act as intermediaries between savers and borrowers. The role of these institutions is vital for economic growth and optimises the saving potential of the public as to meet the demand from the entrepreneurs. It thus, streamlines the information pertaining to borrowers and depositors as well. In this manner it emerged as the organised sector of the financial wing.

Capital market

Capital is one of the factors of production, highly essential to take up any economic activity. Capital market is a vehicle through which long-term finance is channelised to meet the requirements of industry, commerce, Government, and local authorities. In the capital market, private savings - both individual and corporate - are mobilised and made available to industry for meeting its long-term financial needs. The Indian capital market is divided into organised and unorganised sectors.

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The participants in the capital market range from common man to specialised financial institutions. Generally, they include individual investors, investment and trust companies, banks, stock exchanges, and specialist financial institutions.

The suppliers of funds to capital market are individual investors, corporate savings, government savings, foreign investments, banks, financial institutions, investment trusts, insurance corporations, and international financial agencies. Potential users consist of industrial units, traders, government and semi-government institutions. On the other hand, unorganised sector comprises indigenous bankers and moneylenders who supply funds. Usually there is no co-ordination between unorganised and organised segments of the capital market.

Two important constituents of the Indian capital market are: the primary market and the secondary market (see figure 1.2). The primary market helps corporates and the government raise funds by issuing securities. The secondary market, which deals continuous trading activities, provides liquidity in the system. It reflects the changing mood and perception of investors. Stability and growth in the capital market depend on the efficient functioning of the aforesaid since they are interdependent. The securities traded in the Indian capital market are shown in figure 1.2.

Fig 1.3 depicts the classification of securities traded in the Indian capital market and various players involved in it.

Malegam Committee report on disclosure norms aims at improving transparency, quality and completion in the capital market. Many steps have been initiated to improve the activities in the secondary markets. A number of measures such as removal of badla by rolling settlement, monitoring of price movement, introduction of capital adequacy norms for brokers, changes in listing rules, introduction of electronic trading, establishment of National Stock Exchange (NSE) and Over the Counter Exchange of India (OTCEI) were implemented to strengthen the capital market. These have altered the capital market scenario in the country.

Figure 1.2 : Capital market

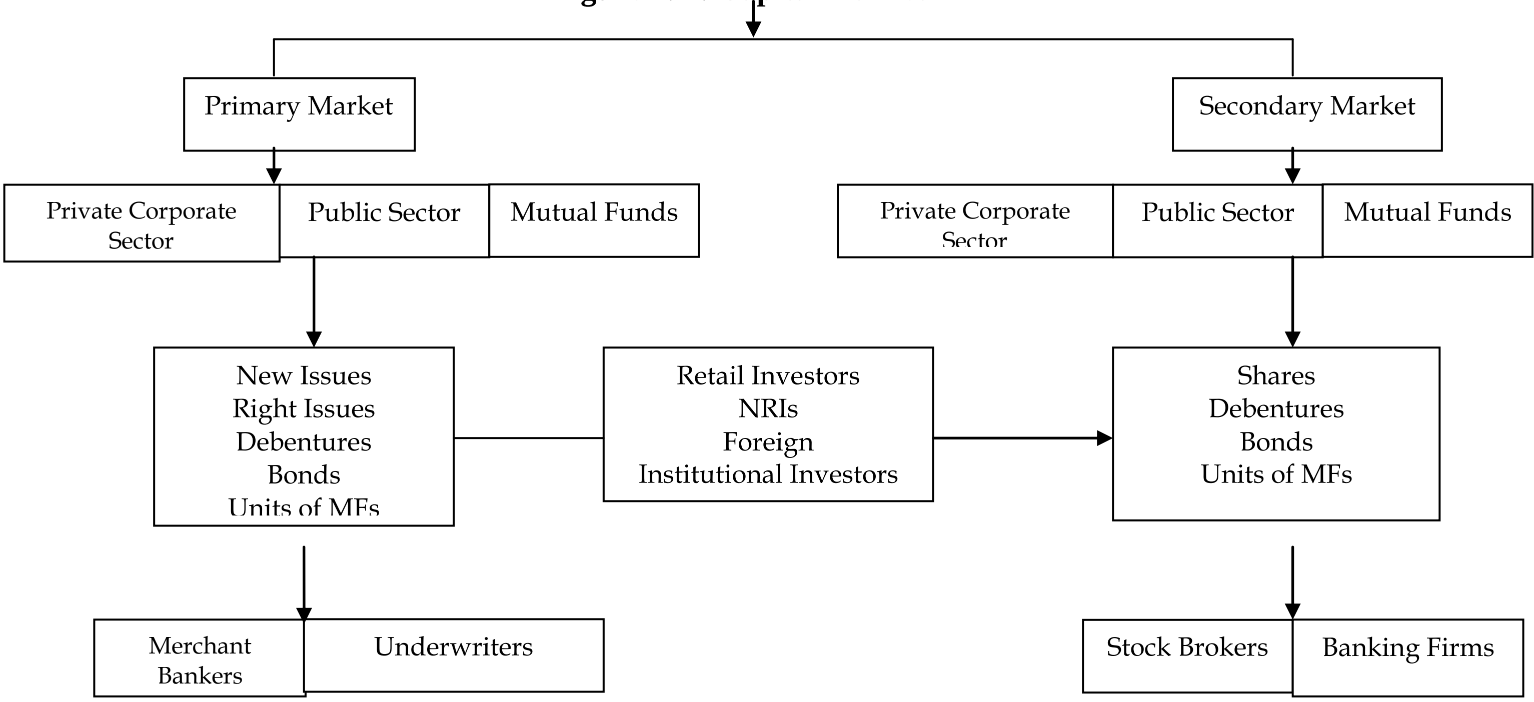
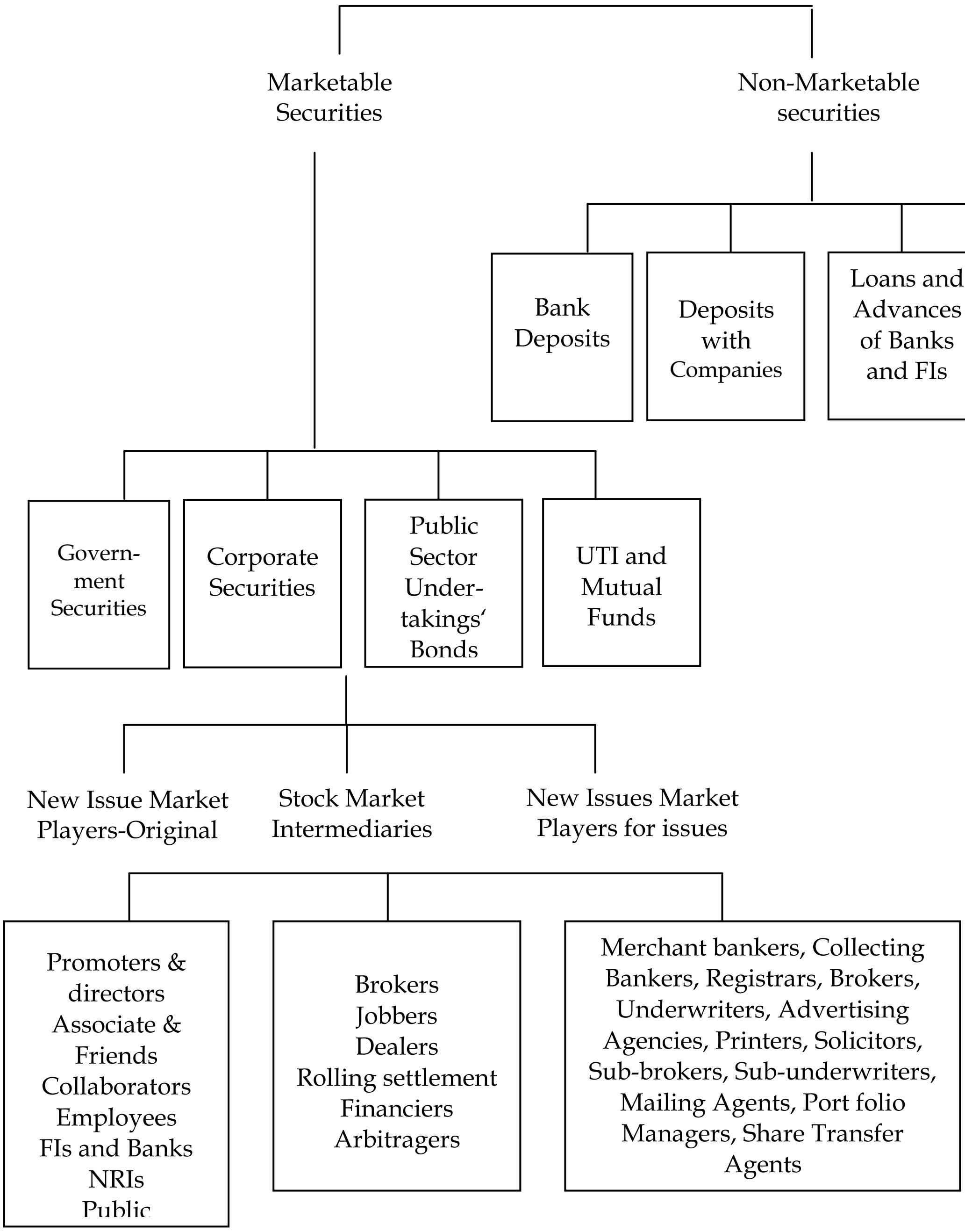


Figure 1.3 : Securities market



Capital market aims at the growth of savings and their mobilisation for investment. Deficit spending units borrow funds from surplus spending units in the capital market. Capital market helps the corporate sector to expand, grow and diversify leading to growth of output, employment and income in the economy. Corporate bodies are now at liberty to enter the capital market to raise any quantum of funds. Corporates are free to price the initial public offers. In the capital market, financial and investment institutions and banks lend long-term loans and act as intermediaries. Besides, companies can raise funds through issue of equity and preference shares and debt securities.

Conclusions

Financial activities in the world are fast changing and the borders are widening beyond imagination. The early form of banking, say, the goldsmith banking, took leap to present day online banking. In the changing scenario, the definition of banking is also to be revised thoroughly and to be either shortened or widened to suit the present day circumstances.

The financial activities differ in their nature depending upon the requirements of the borrowers – may be from households, consumers, producers, traders, commercial service personnel or professional and so on. Peculiarly, right dog to god, every one wants finance, but in a different way and size. Therefore to address the necessities of the people in demand, different forms of financial facilities, instruments, and arrangements came into being. Apart from those who want, even for those who have surpluses lying idle with them, the banks do intermediary activities.

The financial structure or market in India has two basic forms – organised and unorganised. Unorganised sector is highly powerful and also forms lion's share in the financial market. Banking and non-banking financial institutions carry on financial services.

Non Banking Financial Companies (NBFCs) are basically in the sectors of leasing, insurance, financing, capital markets etc. Now a days, NBFCs have attained paramount importance in the economic activities of the country in particular, and on global scale at large.

Capital Market, on a wider range, is primarily of two types – primary market and secondary market. As the very names suggest, primary market is there to subscribe to the IPOs or direct public offers made by the companies from time to time by issuing shares or other instruments of finance. This is, in other words, direct subscription to the capital/ instrument issues. Secondary market is a reference, colloquially speaking, to the second hand market i.e., purchase and sale of shares other than by direct subscription. Stock markets, stock exchanges and other media come under this fold.

Whatever may the name be, blood is required for any living being and so also finance for any activity. The question comes who can take the responsibility into the hand? If we observe the savings profile of households, private corporates, public corporates, the potential is more with the private people, but the sources are scattered across millions of people. Some groups of industries (though not all) have surpluses, but they are not ready to part with them for a long time. Either they reinvest for their business purposes or may invest in short -term securities, which yield some return on one hand and also ensure liquidity at any given point of time. Then remains the question of households, who are ocean when clubbed, but bubbles individually. Yet, these bubbles are required duly grouped and diverted for investment and productive purposes.

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