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Financial System in India

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Financial System is a set of institutional arrangements through which financial surpluses in the economy are mobilized from surplus units and transferred to deficit spenders. The institutional arrangements include all conditions and mechanisms governing the production, distribution, exchange and holding of financial assets or instruments of all kinds and the organizations as well as the manner of operations of financial markets and institutions of all descriptions. Primary securities and secondary securities. The former are financial claims against real-sector units, for example, bills, bonds, equities etc. They are created by real-sector units as ultimate borrowers for raising funds to finance their deficit spending. The secondary securities are financial claims issued by financial institutions or intermediaries against themselves to raise funds from public. For examples, bank deposits, life insurance policies, UTI units, IDBI bonds etc. Financial system promotes savings by providing a wide array of financial assets as stores of value aided by the services of financial markets and intermediaries of various kinds. For wealth holders, all this offers ample choice of portfolios with attractive combinations of income, safety and yield. With financial progress and innovations in financial technology, the scope of portfolio choice has also improved. Therefore, it is widely held that the savings-income ratio is directly related to both financial assets and financial institutions. That is, financial progress generally insures larger savings out of the same level of real income. As stores of value, financial assets command certain advantages over tangible assets (physical capital, inventories of goods, etc.) they are convenient to hold, or easily storable, more liquid, that is more easily encashable, more easily divisible, and less risky. A very important property of financial assets is that they do not require regular management of the kind most tangible assets do. The financial assets have made possible the separation of ultimate ownership and management of tangible assets. The separation of savings from management has encouraged savings greatly. Savings are done by households, businesses, and government. Following the official classification adopted by the Central Statistical Organization (CSO), Government of India, we reclassify savers into household sector, domestic private corporate sector, and the public sector. The household sector is defined to comprise individuals, non-Government, non-corporate entities in agriculture, trade and industry, and non-profit making organizations like trusts and charitable and religious institutions. The public sector comprises Central and state governments, departmental and non-departmental undertakings, the RBI, etc. The domestic private corporate sector comprises non-government public and private limited companies (whether financial or non-financial) and corrective institutions. Of these three sectors, the dominant saver is the household sector, followed by the domestic private corporate sector. The contribution of the public sector to total net domestic savings is relatively small. Financial system is a highly efficient mechanism for mobilizing savings. In a fully-monetized economy this is done automatically when, in the first instance, the public holds its savings in the form of money. However, this is not the only way of instantaneous mobilization of savings. Other financial methods used are deductions at source of the contributions to provident fund and other savings schemes. More generally, mobilization of savings taken place when savers move into financial assets, whether currency, bank deposits, post office savings deposits, life insurance policies, bill, bonds, equity shares, etc. Another important function of a financial system is to arrange smooth, efficient, and socially equitable allocation of credit. With modem financial development and new financial assets, institutions and markets have come to be organised, which are replaying an increasingly important role in the provision of credit. In the allocative functions of financial institutions lies their main source of power. By granting easy and cheap credit to particular firms, they can shift outward the resource constraint of these firms and make them grow faster. On the other hand, by denying adequate credit on reasonable terms to other firms, financial institutions can restrict the growth or even normal working of these other firms substantially. Thus, the power of credit can be used highly discriminately to favor some and to hinder others.