Unit-I

Lecture-2

Financial Institutions

The financial institution is the first component of the financial system. These institutions serve as a mediator in between the borrower and investors that arranges their meeting. It brings together the one who have surplus funds and one who is in need of funds. They are government or private entities that provides distinct services for management of services to businesses and general public.

Financial institutions perform the role of mobilizing investors' savings either directly or indirectly through financial markets using distinct financial instruments as well as in process using various financial services.

Financial institutions can be categorized into: **Banking and Non-Banking institutions.** Banking institutions are one that accepts deposits as well as provide credit to individuals. Whereas, non-banking institutions do not accept deposits from public but offer them various types of financial products and services.

Financial institutions are the **intermediaries** who facilitate the smooth functioning of the financial system by making investors and borrowers meet. They mobilize savings of the surplus units and allocate them in productive activities promising a better rate of return. Structure of Indian Financial System also provides services to entities (individual, business, government) seeking advice on various issues ranging from restructuring to diversification plans. They provide whole range Of services to the entities who want to raise funds from the markets or elsewhere. The financial Institutions is very important for the function of a financial system

Financial Markets

Financial market is place where financial assets are created and transferred among public. It is market in which buyer and sellers interact with one another for entering into transactions related to trading of assets like shares, debentures, bonds etc. These markets facilitate borrowers in finding lender for raising funds. Businesses are able to finance their operations and achieve growth by attracting different investors with the help of financial markets.

Functions of financial markets are:

(i) To facilitate creation and allocation of credit and liquidity

(ii) To serve as intermediaries for mobilisaton of savings.

(iii) To assist the process of balanced economic growth.

(iv) To provide financial convenience.

(v) To cater to the various credit needs of the business houses.

Types of the financial market

- Money Market
- Capital Market

Money Market

Money market is wholesale debt market for high liquidity, low risk and short-term instruments. It is a marketplace where securities with a maturity period ranging from single day to one year are bought and sold. Banks, Government and large financial institutions have full control over the money market.

The importance/functions of the money market is highlighted as under:

1. **Economic development**: The money market provides short term funds to both public and private institutions. These institutions need money to finance their capital needs.
In other words, the money market assures supply of funds; the financing is done through discounting of the trade bills, commercial banks, acceptance houses, discount houses and brokers. In this way, the money market helps in the economic development by providing financial help to trade, commerce and industry. The businessmen take advantage by investing their cash in highly liquid assets to earn income and also to enjoy liquidity because these assets can be converted into cash without much difficulty.

2. Profitable investment: The commercial banks deal with the deposits of their customers. The banks are required to put their assets into cash form to meet the directions of the central bank on the one hand, while on the other, they have to put their excess reserves into productive channels to earn income on them. The aim of the commercial banks is to maximize profits. The excess reserves of the banks are invested in near money assets.

3. Borrowings by the government:
The money market helps the government in borrowing short term funds at very low interest rates. The borrowing is done on the basis of treasury bills. But in case the government resorts to deficit financing or to print more currency or to short term funds at the money supply over and above the borrow from the central bank, it will merely raise Thus it is clear that the needs of the economy and hence the price level will boost up. Money market is very useful for the government since it meets its financial needs.

4. Importance for central bank:
If the money market is well - developed, the central bank implements the monetary policy successfully. It is only through the money market that the central bank can control the banking system and thus contribute to the development of trade and commerce. The money market is very sensitive a change in one sub – market affects the other sub - markets immediately. It means the central bank can affect the whole money market by changing just one sub - market.

5. Mobilisation of funds:
The money market helps in transferring funds from one sector to another. The development of any economy depends on availability of finance. No country can develop its trade, commerce and industry until and unless the financial resources are mobilized.

6. Savings and investment
The money market is that it helps in promoting liquidity and safety of financial assets. By doing so it can help in encouraging savings and investment. The saving and investment equilibrium of demand and supply of loanable funds helps the allocation of resources.