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B.Com Honours

Semester I

Calicut University

Basics of Financial Markets

Course Code: COM1MN105 • Module 1 Notes

1. Indian Financial System: Concept and Structure

A financial system is a complex, integrated network of institutions, markets, instruments, and services that facilitates the flow of funds from savers (surplus units) to borrowers (deficit units). By mobilizing idle savings and channeling them into productive investment avenues, a financial system acts as the engine of capital formation, economic growth, and wealth creation in a nation. This module introduces the definition, scope, features, and key constituents of the Indian Financial System, followed by an overview of the regulatory bodies that govern its operations.

Defining the Financial System

The financial system can be conceptualized as a bridge between savers and investors:

- **Concept:** It collects funds from households and channels them to business enterprises and governments for capital expenditure and infrastructure development.
- **Economic Significance:** It directly influences economic development by pricing risks, allocating capital to the most efficient ventures, and maintaining systemic liquidity.

Functions of the Financial System

A well-functioning financial system performs several vital services in an economy:

- **Capital Formation:** It provides a mechanism for mobilizing household savings and directing them into corporate investments.
- **Systemic Liquidity:** It facilitates transactions by providing payment systems (e.g., banking clearing systems, UPI, digital deposits).
- **Risk Allocation:** It offers financial contracts (e.g., insurance, derivatives) that allow individuals and firms to hedge, pool, or transfer risks.
- **Information Provision:** It provides price signals (e.g., stock prices, interest rates) that reflect the health and prospects of companies and the economy.

Constituents of the Indian Financial System

The Indian Financial System consists of four primary elements:

Financial Institutions

Intermediaries that facilitate the transfer of funds. Divided into Banking Institutions (Commercial, Co-operative, RRBs) and Non-Banking Financial Institutions (NBFCs, Insurance, Mutual Funds).

Financial Markets

The physical or digital spaces where buyers and sellers trade assets. Classified into Money Market (short-term) and Capital Market (long-term).

Financial Instruments

Legal contracts representing a monetary claim. E.g., Equity shares, Debentures, Treasury bills, Certificates of Deposit, and Derivatives.

Financial Services

Services that assist in the purchase/sale of assets. E.g., Merchant banking, underwriting, depository services, credit rating, and leasing.

2. Financial Regulators in India

To protect investor interests and maintain systemic stability, the Indian financial system is regulated by several specialized statutory authorities:

Regulator	Sector / Domain	Core Functions and Roles
Ministry of Finance	Apex fiscal authority.	Formulates fiscal policy, presents the Union Budget, coordinates financial sector rules.
Reserve Bank of India (RBI)	Banking system & Money market.	Acts as central bank, issues currency, controls inflation (monetary policy), regulates commercial banks and NBFCs, manages foreign exchange.
Securities & Exchange Board of India (SEBI)	Capital market & Mutual funds.	Regulates stock exchanges, protects interests of retail investors, prevents market manipulation and insider trading.
Insurance Regulatory & Development Authority (IRDAI)	Insurance sector.	Regulates life and general insurance companies, protects policyholders, ensures solvency of insurers.
Pension Fund Regulatory & Development Authority (PFRDA)	Pension schemes.	Regulates and promotes the National Pension System (NPS) and other pension products.

Significance of Financial Regulation

Without robust regulation, financial systems are vulnerable to systemic crises, market manipulation, and corporate frauds (e.g., Ponzi schemes). Regulators maintain public trust, ensure capital adequacy among banks (Basel norms), and enforce transparent disclosures by listed corporations.

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