SYLLABUS

B.B.A. V SEM

Subject – Indian Financial Systems

UNIT – I	CONCEPT OF FINANCIAL SYSTEM; Formal and informal financial systems, Functions of financial system, Nature and Role of financial institutions and financial markets, Financial system and the economy.
UNIT – II	MONEY MARKET: Emerging Structure of Indian Money Market; Instruments of Money Market; Money Mutual Funds — An Overview and 1213I's Regulatory Guidelines; Commercial Banks — Role in Industrial Finance and Working Capital Finance.
UNIT – III	CAPITAL MARKET: Concept, Structure and Functions of Capital Market; Primary Market- Instruments of Issue and Methods of Flotation; Secondary Market — Concept, Market Players, trading System and Settlement.
UNIT – IV	INSTITUTIONAL STRUCTURE — INDIAN FINANCIAL INSTITUTION: Development Banks- FCLICICI, Sits and IDBI: Investment Institutions — UTI and other Mutual Funds; Insurance Organization- Life Insurance Corporation of India, SEI31: Scope and Functions, Objectives of SEBI.
UNIT – V	FINANCIAL PRODUCTS: Leasing, Hire Purchase, Factoring and Forfeiting.
UNIT – VI	CREDIT RATING: Meaning, Functions, Importance. DERIVATIVES: Basic Introduction

Unit – 1

Concept of Financial System-

A financial system plays a vital role in the economic growth of a country. It intermediates with the flow of funds between those who save a part of their income to those who invest in productive assets.

A financial system is a complex, well integrated set of sub- systems of financial institutions, markets, instruments and services which facilitates the transfer and allocation of funds, efficiently and effectively.

Formal and informal Financial systems –

The Indian financial system can be classified into the formal financial system and the informal financial system.

Formal Financial System – The formal financial sector is characterized by the presence of an organized, institutional and regulated system which caters to the financial needs of the modern spheres of economy. This system comes under the purview of the ministry of finance, Reserve Bank of India, Securities and Exchange Board of India and other regulatory bodies.

Informal Financial system – The informal system is characterized by flexibility of operations and interface relationships between creditor and debtors. The informal system consists of –

a. Individual moneylenders such as neighbours, relatives, landlords, traders, storeowners and so on.
b. Groups of persons operating as 'Funds' or 'association."
c. Partnership firms consisting of local brokers, pawn brokers and non-bank financial intermediaries such as finance, investment and chit fund companies.

Components of formal financial system-

1. Financial Institutions – These institutions mobilize saving and facilitate the allocation of funds in an efficient manner.
2. Financial Markets – Financial markets are a mechanism enabling participants to deal in financial claims. The market also provide a facility in which their demands and requirements interact to set a price for such claims.
3. Financial Instruments – A financial instrument is a claim against a person or an institution for the payment at a future date a sum of money and/or a periodic payment in the form of interest or dividend.
4. Financial Services- Financial intermediaries provide key financial services such as merchant banking, leasing, and hire purchase, credit-rating and so on. Financial services rendered by the financial intermediaries bridge the gap between lack of knowledge on the part of investors and increasing sophistication of financial instruments and markets.

Functions of the financial system –

1. Mobilisation of savings effectively
2. Savings are allocated efficiently among the ultimate users of funds (investors).
3. Increases savings by postponing present consumption.
4. Banking and financial institutions collect the domestic savings and place in the hands of the users of the funds.
5. Proper investment (productive users) is possible through the financial system.
6. The real capital formation in which the banking and financial institutions act as intermediaries to bring the savers and investors together.

Role of Financial Institutions

Financial institutions are business organizations serving as a link between savers and investors and so help in the credit-allocation process. Good financial institutions are vital to the functioning of an economy. Financial institutions provide three transformation services:

1. Liability asset and size transformation consisting of mobilization of funds, and their allocation by providing large loans on the basis of numerous small deposits.
2. Maturity transformation by offering the savers tailor-made short-term claims or liquid deposits and so offering borrowers long term loans matching the cash flows generated by their investment.
3. Risk transformation by transforming and reducing the risk involved in direct lending by acquiring diversified portfolios.

Role of Financial Markets –

A financial market is a mechanism for the exchange trading of financial products under a policy framework. Financial markets perform various functions such as –

1. Enabling economic units to exercise their time preference.
2. Separation, distribution, diversification and reduction of risk.
3. Efficient payment mechanism
4. Providing information about companies.
5. Transformation of financial claims to suit the preferences of both savers and borrowers.
6. Enhancing liquidity.
7. Portfolio management

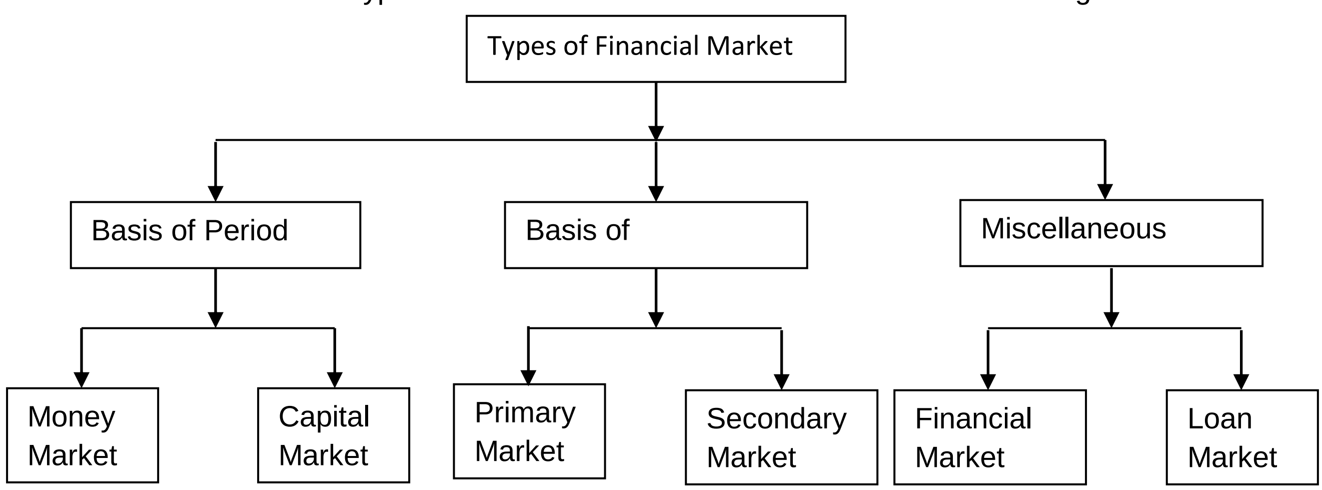
Types of Financial Market

Financial markets are institutions and procedures that facilitate transactions in all types of financial claims. The purchase of home, the common stock and the life insurance policy all take place in some of financial markets.

Some economic units such as households, firms or governments, spend more during a given period than they earn. Other economic units spend less on current consumption than they earth.

Financial markets exist in order to allocate the supply of savings. The main characteristic of a financial market is that it acts as the vehicle through which the forces of demand and supply for a specific type of financial claim are bought together.

The financial markets can be classified into various categories as the diversified financial transaction take place in such market. The instruments used in these markets are very basis of the classifications. The types of financial markets can be seen from the following chart –



On the basis of period of market – The financial market is classified into two categories – the transactions made on the basis of short term documents is called money market while the purchase and sale of long term documents are finalized in the capital market.

On the basis of financial instruments used – The financial market is classified two categories – when various companies and the Government issue financial instruments for the first time and they are bought and sold by financial institutions, they called primary financial markets. When the instruments are already available in the market and they are bought and sold is called secondary financial market.

Financial markets are also classified on the basis of their functions when banking institutions provide only financial services in addition to deposits and withdrawals, for example, purchase and sale of shares or securities on behalf of customers and charges are made for such services, then the market is called financial service market. When brokers or commission agents help in purchase and sale of shares and debentures and charges are made for these services the activities are covered under financial service market. When consumer credit is provided by financial institutions and terms loans are given the market carrying such activities is called loan for debt market. The loan market may be short term, medium term and long term.

Money Market

Meaning and Definition – Money market has been defined by different writers and authorities as given under –

1. According to Crowther, 'The money market is the collective name given to the various firms and institutions that deal in the various grades of near money."
2. R.s. Sayers has defined, "The money market properly speaking is the market for short-term and day-to-day loan."
3. According to Nadler, Heller and Shipman, "A money market is a mechanical device through which short term funds are loaned and borrowed and through which a large part of the financial transactions of a particular country to world are degraded. Money is distinct from but supplementary to the commercial system."
4. Mobilization of savings – Public savings is scattered. These savings are mobilized and collected through financial institutions. These institutions are post offices, banks, company deposits, L.I.C., U.T.I. etc. These savings are used to finance various plans. The instruments of savings account, fixed deposit accounts, recurring deposit multipurpose deposits of banks, unit of UTI and policies issued by the LIC of India.
5. Investments of savings – Financial markets not only collect and mobilize savings but they have also invested into productive uses. The rate of economic growth is accelerated by the capital formation and the rate of investment is increased for capital formation. When the competition among securities raises the price and the rate of interest is reduced. This increases investment. Thus financial markets play an important role in the management of investment.
6. Helpful to Non-financial sectors – Various types of securities are issued in capital market by the financial market. The securities comprise of shares, debentures, bonds, stock, mortgage etc. These securities are transferred in non-financial business sector by the further used in purchasing securities. Businessmen borrow money for various schemes. Thus non-financial sectors are helped by financial market.
7. Helpful to Government – Finance is made available by purchasing securities, bonds, stocks, etc. issued by the central government, state governments, local bodies and semi governments corporation in the finance market. This helps in accomplishing the various plans which were held up due to paucity of funds.
8. Economic development of country – The economic development of a country depends upon capital formation and development of each sector in the economy.

Financial markets encourage savings, collect these savings and invest them in basic infrastructure – construction of roads, dams, setting up of new industries which lead to capital formation. This generates self-reliance in each sector. Financial markets comply with the monetary and credit policies of the RBI and they are amended from time to time by which economy gets a strong base. This accelerates the capital formation and thereby the rate of economic development is accelerated.

9. Increases in Monetary Liquidity – Financial institutions operate such policies in the financial markets which maintain the monetary liquidity. For example, banks create credit and provide short term, medium term and long term loans by which the equilibrium is attained between the demand for and supply of money. The supply of working capital keeps the production cycle in process in commercial and industrial sectors. For example, purchase of raw materials, semi-production, and production, sales in the market and conversion in cash maintain the demand and supply of money.
10. Increase in Efficiency of Lenders – When there is equilibrium between demand for any supply of loanable funds in the financial markets then it is considered that the debtors and creditors are working efficiently. This situation can be attained when both the parties depend on several factors. The demand for loanable funds in the financial markets arises to investment in mortgages, stock, bonds, securities of the central government. State government and local bodies, movable capital, demand for credit is affected by several factors namely interest rates, inflation, business profit, consumer's habit, nature, change in fashion and the tax rates etc.
    The supply of loanable funds is from commercial banks, savings banks, mutual funds, LIC of India, UTI, financial institutions, non-banking companies, individuals, savings organizations etc. These participants make available the funds taking into consideration the market conditions. Thus financial markets maintain the equilibrium between demand for and supply of loanable funds and consequently their efficiency increases.
11. Implementation of credit policy – Financial markets implement the credit policy and monetary policy of the Reserve Bank of India. These policies are changed from time to time which leads to full capacity utilization in the financial markets.
12. To implement monetary policy of RBI – Money market helps in implementing monetary policy of the RBI in financial market. Financial market plays an important role in the implementation of credit policy, banking and other policies.

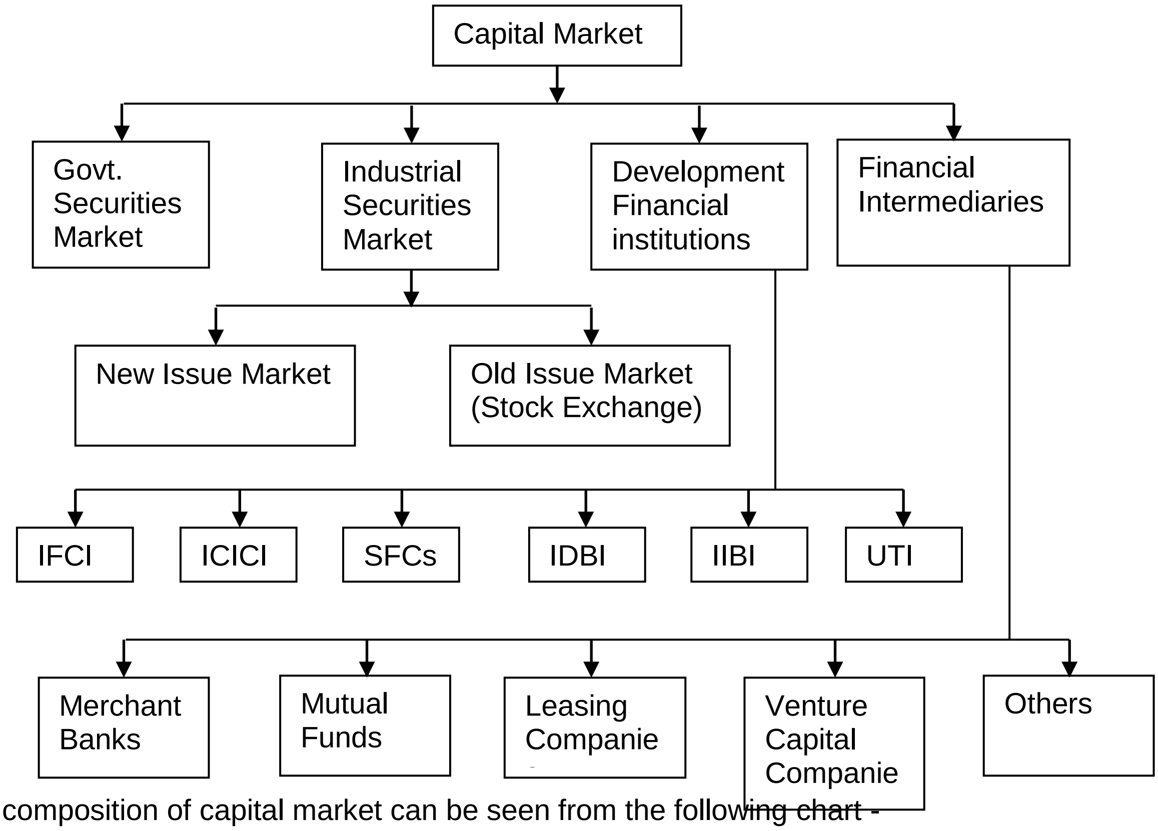
Salient Features – On the basis of the different definitions we can conclude that money market has the following salient features –

1. Money market deals with short term transactions.
2. These short term transactions have the duration from 1 day to one year only.
3. There are short term monetary assets in the in the money market, these comprise of commercial paper, treasury bills, deposit certificates, call money, government bills, sanctions of banks, inter-bank loans, mutual funds, bill of exchange. These assets are bought and sold in the market.
4. Equilibrium between short term demand for finance and supply of finance is attained.

In short we can say that money market is a wholesale market of financial assets wherein the short term transactions take place. Such transactions are limited to participants only.

Capital Market

This is one of the types of financial markets. Capital markets are the market for long term funds. Capital market refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium and long term funds). It is concerned with eh raising of money capital for the purpose of investment.



The composition of capital market can be seen from the following chart -

Capital market is composed of those who demand funds (borrowers) and those who supply funds (lenders). An ideal capital market provider's adequate capital at reasonable rate of return for any business or industrial proposition which offers a prospective field high enough to make borrowing worthwhile. The rapid expansion of the corporate and public enterprises has necessitated the developments o capital market.

Salient features – Capital market has the following salient features –

1. Capital market deals in long term transactions of securities.
2. The duration of such transactions is from 45 to 20 years.
3. The instruments used in the capital market comprise of shares, debentures, bonds, Government securities, preference shares, mutual funds, units insurance premium risk capital, lease finance and credit.
4. The loans are related to housing loan, consumer loan, mortgage loan, educational loan etc.
5. The participants in capital market are financial institutions, corporations, companies governments, commercial banks, LIC, GIC and stock Exchanges.

Foreign Exchange Market

International trade and investment would not be possible without the mechanism for buying and selling foreign currencies because the rupee is not the international means of exchange. The foreign Exchange Market (FEM) is a necessary arrangement to international transactions in an open economy. This is cleared at the exchange rate which is an important part of financial markets. The international aspects of savings and investment are reflected in the volume of capital flows between two or more than two countries.

The rate at which two countries' currencies are exchanges is called exchange rate. Foreign exchange is highly qualified claims denominated in foreign monetary units.

According to Foreign Exchange Regulation Act of 1973 foreign exchange means foreign currency and it comprises of –

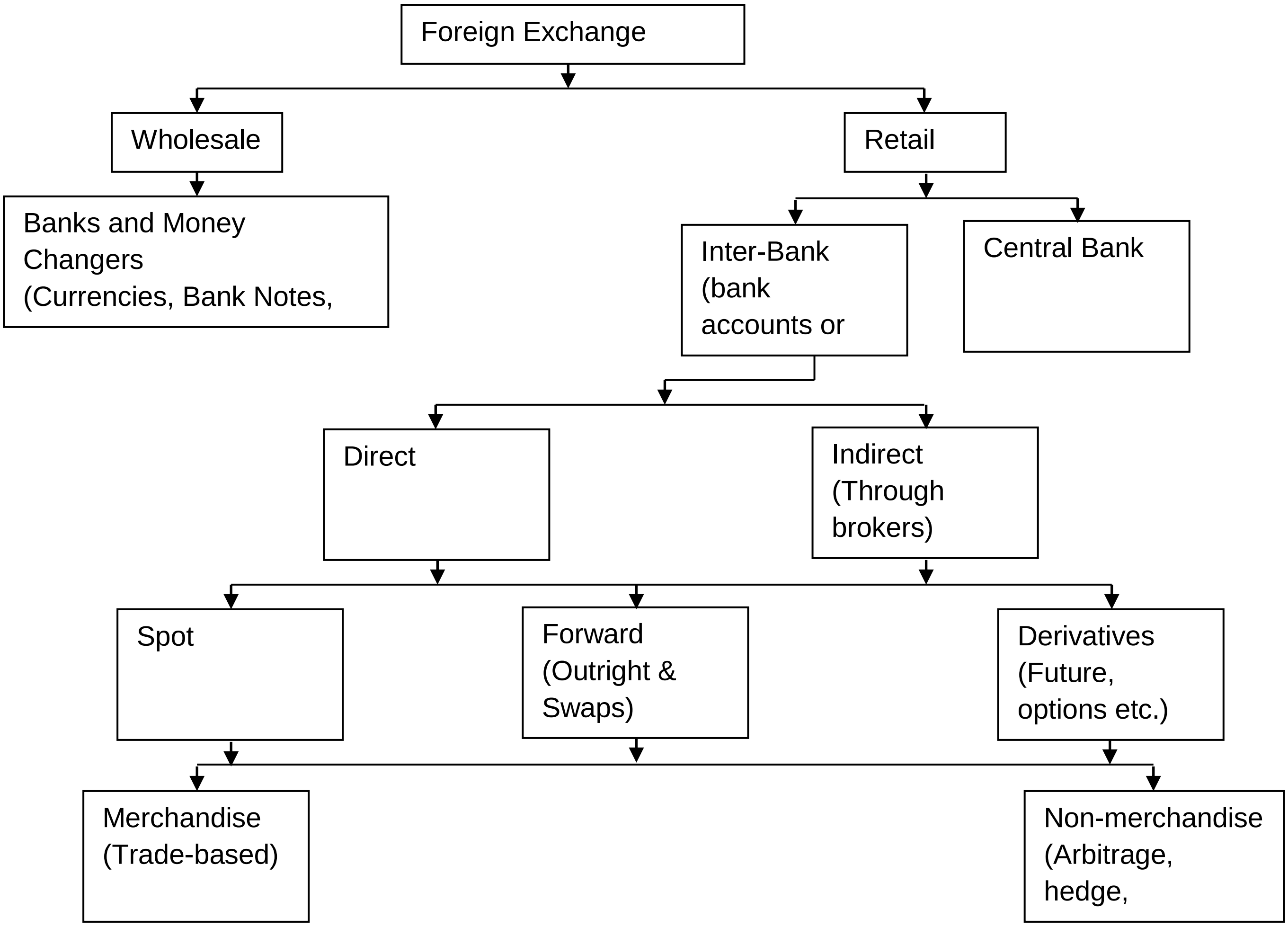
a. All deposits, credits and balances payable in any foreign currency and any drafts, traveler's cheques, letters o credit and bills of exchange drawn in Indian currency but payable in any foreign currency; and
b. Any instrument payable at the option of the draw or holder thereof or any other party either in Indian currency or in foreign currency. Thus, the market in which national monetary units is called Foreign Exchange Market. It is an informal, electronically linked network of bog banks, foreign exchange brokers and dealers whose function is to bring buyers and sellers together.

Foreign exchange market is dispersed throughout the big and small financial centres in the world. Some of these are in London, New York, Paris, Zurich, Tokyo, Milan and Frankfurt.

The organization and structure for foreign exchange market can be seen from the following chart –

Thus, we can say that Foreign Exchange Market (FEM) is the market electronically linked network of big banks, foreign exchange brokers and dealers whose functions is to bring buyers and sellers together. Trading is usually done 24 hours a day telephone, display monitors, telex and fax machines and ht satellite communications network which is a computer based communication system.

Banks have been authorized by the RBI to deal in foreign exchange and some of the financial institutions such as IDBI, ICICI, IFCI etc. have been given licence to undertake forex transactions incidental to their main business activities. The currencies are traded by the RBI on its own behalf and also on behalf of the Government.



Salient features – Foreign Exchange Market has the following salient features –

1. This market deals in foreign exchange
2. Foreign transactions are finalized in the market.
3. This market is dispersed throughout the big and small financial centres in the worlds.
4. This is usually 24 hours working market.
5. This market comprise retail (Banks and money changers) and wholesale (interbank and central bank.)
6. The central bank regulates and controls the dealing in foreign exchange through Foreign Exchange Regulation Act. Dealers in foreign exchange are banks, financial institutions, RBI and the Government. Authorized dealers are given licences by the central bank.

Insurance Market

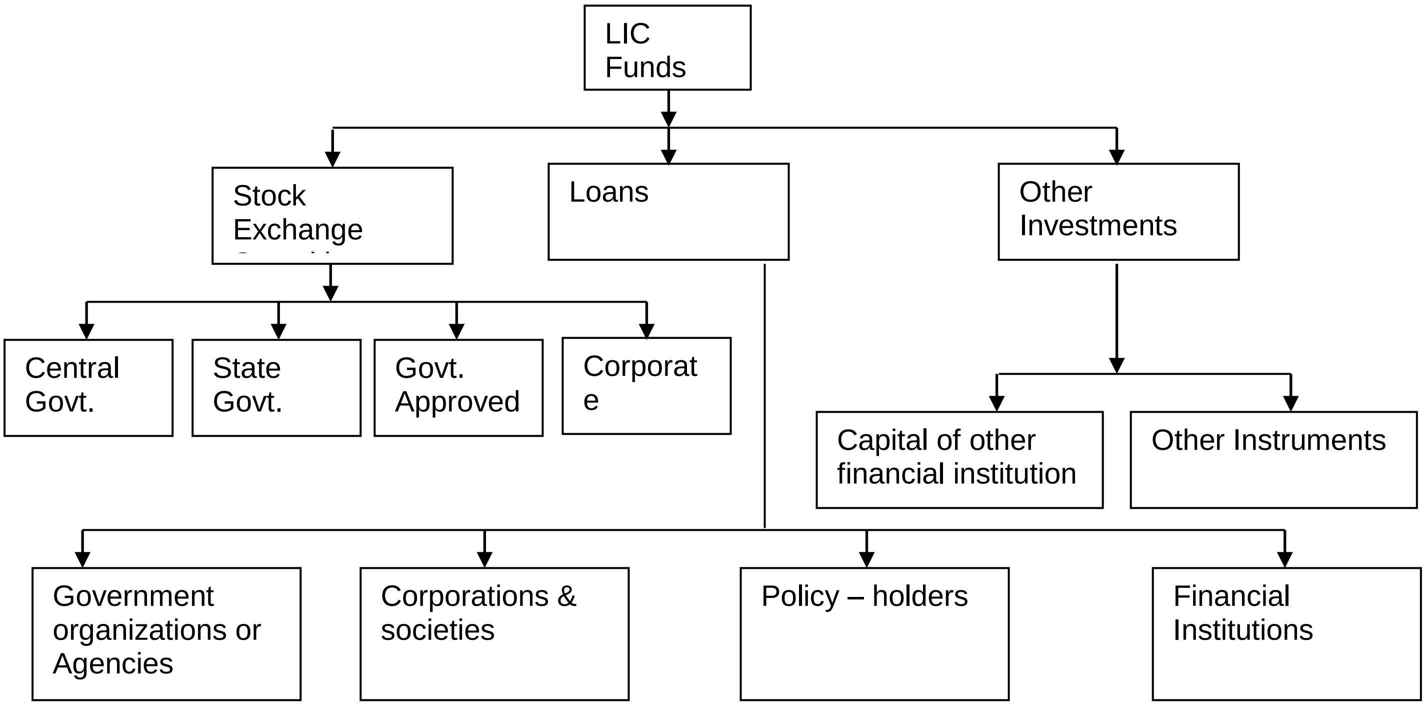
Insurance companies are financial intermediaries as they collect and invest large amount of premiums. These institutions offer protection to investors, provide means for accumulating savings, and channelize funds to the government and other sectors in the economy. Investment of insurance companies has been largely in government bonds, mortgages, state and local (municipal) government claims and corporate bonds.

Insurance companies are active in the fields, of life, health and general and they have started the pension schemes and mutual funds also. Insurance business consists of spreading risks over time and sharing them between persons and organizations. The major part of insurance business is life insurance, the operations of which depend on the laws of mortality. The insurance, the operation of which depends on the laws of morality. The basic difference between life and general insurance business is that with regard to the former, the claim is fixed and certain, but in the case of the latter, the claim is uncertain and the claim is ascertainable only some time after the event. Pension business is a specialized form of life assurance.

Thus the market where insurance business is carried on by providing policies in the fields of life, health and general to protect the interest of policy holders is called Insurance Market. Policy- holders contribute in the form of premiums to the insurance companies and get the benefits of insurance.

LIC of India and GIC of India have been mobilizing savings of the public to specifically invest in industrial securities. These institutions collect large amounts of funds from the general public to provide insurance cover but they use part of their funds to give long term loans to the corporate sector or acquire industrial securities (shares and debentures) from the market. These two institutions have become powerful operations in the stock exchange.

The major portion of the LIC's funds are required to be invested in government approved securities and socially oriented sector and only a smaller proportion is to be invested in the private sector. The broad pattern of employment of LIC's funds is given in the following chart –



Salient features – The following are the salient features of insurance market –

1. Insurance market deals in insurance business wherein the insurance companies and policy holders are the participants.
2. Insurance policies in the fields of life, health and general are issued by the insurance companies.
3. Premiums are paid by the policy-holders and they get the benefits of the policies as per the norms prescribed in the policies.
4. Insurance companies are financial intermediaries. They collect and invest large amounts o premium from the policy holders.
5. The mobilization of savings of the public are used in the long term loans to the corporate sector or acquire industrial securities (shares and debentures) from the market.
6. The major portion of insurance companies is invested in government approved securities and socially oriented sectors.

The most important event during 1999-2000 was in the field of contractual savings. The Insurance Regulation and Development Authority Act have been passed. This Act ends the monopoly of the government in the insurance sector because it seeks to promote the private sector in the insurance sector. It gives priority in the utilization of policy-holders' funds for the development of social and infrastructure funds. The government has given licences to a number of private sector companies to do insurance business.

The insurance business has been increasing in public as well as private sector providing the safety and security of life and old age benefits with protection from insurable risks in case of movable and immovable assets.

Unit – 2

Indian Money Market

Money Market provides the funds for market participants with maturity of one day to one year. The Reserve Bank of India, Commercial Banks, Financial institutions and the primary Dealers are prominent players in this market. The call/Notice Money Market provides funds for banks with a maturity range of 2 to 14 days. The market with a maturity of 15 days to one years the term money market.

Some of the characteristics of the money market are as given under –

1. The market bridges the gap between the demand for and supply of short term funds in the economy.
2. The market is a hub of activities influencing the liquidity and general level of interest rates in the economy.
3. The market facilities the landing/borrowing activities at fair and competitive rates.

Evolution of Indian Money Market

The Vaghul Committee, a working group of money market appointed by RBI under the chairmanship of N.Vaghul had suggested measured to develop the money market in India. The RBI has taken initiative as a follow up of the recommendations given by the Committee a sunder:

1. Discount and Finance House of India (DFHI) was set up in March' 1988 to enable liguidy of the money market instruments.
2. Widening the rage of money market instruments and introduction of new instruments like Cp] CD and interbank participation certificates during 1988-89.
3. Interest rate regulations in call money markets were adjusted to the market forces of demand and supply.

Money market is a market for short term financial assets which are near substitutes for money. Money market instruments are liquid and can be turned over quickly at low transactions cost and without loss. Money market instruments are for short duration. It is the market where the short term surplus investable funds of banks and other financial institutions are demanded by borrowers comprising individual companies and the government. Commercial banks are both suppliers of funds in the money market and borrowers.

Objectives of money market – There are following objectives of money market:

1. It provides an equilibrium mechanism between short term surplus and deficits.
2. The money market is focal point for central bank intervention for influencing liquidity in the economy.
3. This market provides reasonable access to users of short term money to meet their requirements.

Importance of money market – The money market plays an important role in trade, commerce and financial system in an economy as given under –

1. This market is an important source of financing trade and industry through bills, commercial papers etc.
2. Availability of funds and interest rates in money market have an impact on interest rates and resources mobilization in the capital market.
3. This market offers an avenue to the commercial banks for inventing short term surplus of finds and borrowing for short term needs to meet the cash Reserve Ratio (CRR) and Statuary Liquidity Ratio (SLR) requirements.
4. Money market facilitates effective implementation of monetary policy of the central banking in an economy.
5. Money market is an important guide to the government in formulating, amending and implementing its monetary policy.

6. This market provides the government an important non-inflationary measure of raising short term funds through bills subscribed by commercial banks and the public.

Money Market players

The transactions that take place in the money market are the high volumes. The market is dominated by a relative small number of large players. The following are the intermediaries participating in the money market –

1. Government
2. Central Bank
3. Financial Institutions
4. Corporate Units
5. Other Institutional Bodies – Mutual funds (MFs)' Foreign Institutional Investors (FIIs) etc.
6. Discount Houses and Acceptance Houses

Government is an active money market players and in most of the economies, it is the biggest in the money market. The government borrows funds when its expenditure exceeds its revenue. In such a situation government issues securities in the money market and raises funds.

Corporate also transact in the money market mostly to raise short term funds for meeting their working capital requirements. The sector utilizes both the organized and unorganized money markets.

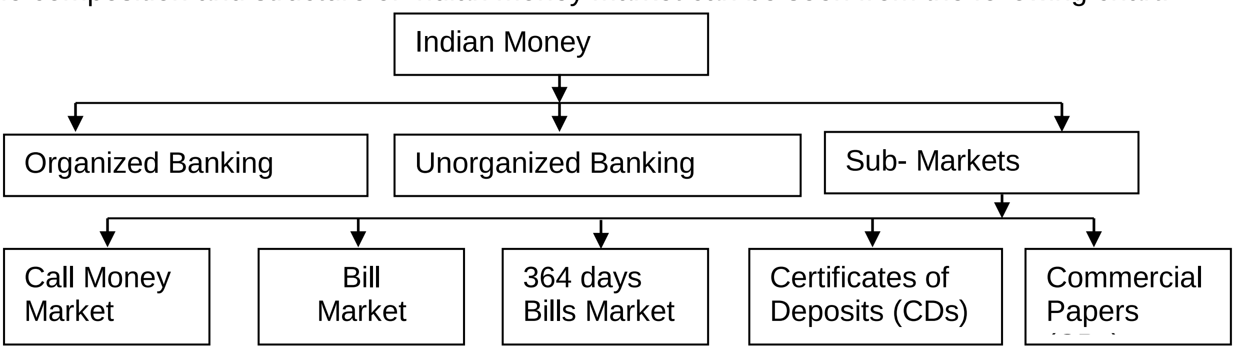
The players and their role can be seen from the following table –

Table 1: Money Market players and their role

Players	Role
Central Bank	Regulatory
Government	Borrower/Issuer
Banks	Borrower/ Issuers
Discount Houses	Market Makers
Acceptance Houses	Market Makers
Financial Institutions (Fis)	Borrowers /Issuers
Foreign Institutional Investors (FIIs)	Investors
Dealers	Intermediaries
Corporate	Issues

Composition and structure

The composition and structure of Indian money market can be seen from the following chart:



The Indian money market comprises of two parts:

1. The organized money market
2. The unorganized money market

The organized money market in India has a number of sub markets such as the treasury bills market, the commercial bills market and the inter-bank call money market. The organized sector comprises the Reserve Bank of India, the State Bank of India and its subsidiaries, the 20 nationalized banks and the other private sector banks in India and abroad.

The unorganized sector consists of indigenous bankers who pursue the banking business on traditional lines and Non-banking Financial Institutions (NBFIs)

Thus, the Indian money market is not a single homogeneous market but is composed of several sub-market, each one dealing with a particular type of short term credit.

Classification of Money Market Instruments
The classification of money market instrument depends upon the type of issuers and their requirements as given under –

1. Government and Quasi-Govt. Securities:
   a. Treasury Bills
   b. Govt. Dated Securities/Gilt Edged Securities
2. Banking Sector Securities
   a. Call and Notice Money
   b. Term Money Market
   c. Certificates of Deposit
   d. Participation certificates
3. Private Sector Securities
   a. Commercial Papers
   b. Bills of Exchange
   c. Inter Corporate deposits/Investment
   d. Money Market Mutual Funds
   e. Bonds/Debentures by the corporate

Features of Indian Money Market
Indian money market has duality. There is organized market wherein the RBI, commercial banks, private banks, development banks' SBI, Non-banking financial institutions and cooperative banks are operating. In NBFIs namely LIC, GIC UTI, IDBI, PF and Finance Corporations are working. On the other hand in unorganized part indigenous bankers and money lenders are operating.

Indian money market has the following features and defects –

1. **Existence of unorganized money market –** The major defect of Indian capital market is the existence of the indigenous bankers who provide finance irrespective of time and purpose. They are not regulated and controlled by the Reserve Bank of India. There is a whole lot of non who are generally outside the control and supervision of the RBI for the last more than 50 years.
2. **Absence of Integration –** Indian money market ha several segments loosely connected to each other. State bank of India and its subsidiaries, the foreign exchange banks, the urban cooperative banks and indigenous bankers are working independently having a particular class of business and there is absence of integration. Both commercial and cooperative banks rely on the rediscounting and borrowing facilities provided by the RBI. Lack of effective control and monitoring of commercial banking sector by the RBI had led to Harshad Mehta Scam in 1992 and Ketan Parekh Scam in 2001.
3. Difference in interest rates : Another defect of Indian money market is related to the existence of too many rates of interest. The borrowing rate of the government, the deposit and lending rates of commercial banks, deposit and lending rates of

cooperative banks, the lending rate of Development Finance Institutions etc. are different in India. The basic reason is the immobility Of funds from one section of money market to another. In recent years the different money rates of interest have been adjusting 'to changes in the bank rate.

4. Seasonal stringency of money : Another feature and defect of Indian money market is the seasonal monetary stringency and high rates of interest during a part of the year. The busy season from November to June when funds are required to move the crops from the villages and up-country districts to the cities and ports. The off-season (slack season from July to October) reflects that banks have large surplus funds and the rates of interest reach low levels. There are wide fluctuations in the money rates of interest from one period of the year to another. RBI has been trying to reduce seasonal fluctuations in the money market, by pumping money into the money market during busy seasons and withdrawing the same during off-seasons. This feature is prevailing even today.
5. Absence of Organized Bill Market – Another defect of the Indian money market is the absence of an organized bill market or discount market for short term bills. A well organized bill market is necessary for linking up the various credit agencies ultimately and effectively to RBI. The bill market was not developed due to several seasons such as the practice of banks keeping a large amount of cash for liquidity purposes, preference. of industry and trade for borrowing rather than rediscounting bills, the improper drafting of the bazar hundi, the system of cash credit as the main form of borrowing from banks, the preference of cash transactions in certain line of activity the absence of warehousing facilities for storing agricultural produce and the high stamp duty on usance bills.

   The bill market scheme introduced by the RBI in 1970 has not developed fully as was anticipated. Treasury bill market, commercial paper, call money market, repos are backward in the country which have not developed the money market in India.
6. Highly volatile call money market: The call money market is the market for short term funds known as "money at call and short notice". This market comprises at the call market or overnight market and short notice market. The rate of which funds are borrowed in this market is called the call money rate. Call money rates are market determined. The demand for short term funds comes from public sector banks (80% of borrowing) and foreign banks and private Sector banks account for 20% only, while some banks operate both as lenders and borrowers, other operate only as borrowers or only as lenders. The suppliers of funds in the call money markets are mostly non-banking financial institutions such as IDBI, GIC etc. (80% of the funds) and remaining 20% of the funds by the banks in the call money market.

   RBI had tried to moderate the fluctuations in the call money rates, these are even today highly volatile.
7. Lack of a well-organized Banking system : There is a lack of well-organized banking system in Indian money market. Branch expansion was very slow before the first major nationalization of commercial banks in July 1969. There are only a few big banks in the country and they are concentrated in large towns and mandies.

   Harsha Mehta Securities Scam in 1992, Ketan Parekh Scam of 2001 and CM Agarwal of Home Trade in the Gilt-edged Market of 2002 have revealed that the Indian banking system is not a well-organized and efficiently supervised system.
8. Lack of credit institutions : There are few credit institutions in Indian money market. UTI, LIC of India, GIC, commercial banks, financial institutions are some of the credit institutions. But these institutions are operating in cities and large towns while credit facilities are not available in rural areas. Money market has not developed due to lack of such credit institutions.
9. Limited availability of credit instruments: Till. 1985-86 there was a limited number of adequate short term paper instruments in Indian money market. There were treasury bill market and Call money market. There were no specialist dealers and brokers dealing in different segments of the Indian money market and in different kinds of

paper instruments. RBI started introducing new paper instruments such as 182 days treasury bills, 364 days treasury bills, certificates of deposits (CDs) and commercial papers (CPs) after 1985-86.

Suggestions for Improving Indian Money Market

The following remedial measures can be suggested to improve Indian money market:

1. Control over indigenous bankers: In order to have a well organized and well developed money market in our country the money lenders and indigenous bankers spreading in rural areas should be controlled. RBI should adopt some effective measures to regulate and control the activities of this unorganized sector.
2. Standardization of Hundies: The Hundies used by indigenous bankers are not accepted by commercial banks. They should be standardized. in order to bring uniformity in Hundies Banking Commission had recommended the Sight and Time Hundies. It will make the transactions easier in the money market.
3. Establishment of financial institutions: Money market can be well developed only where there is a chain of financial institutions. These institutions are acceptance houses, finance and discount houses, credit institutions etc. The establishment of such financial institutions will solve the problems of short term finance in the money market.
4. Development of bill market: Reserve Bank of India should issue new directives to develop bill market in the country. For this purpose the following measures are suggested :
    a. To increase the business through bills.
    b. To reduce the stamp duty
    c. To establish clearing houses
    d. To reduce the discount rates
    e. To set up acceptance houses
    f. To set up more warehouses
    g. Acceptance of bills on the security of crops.
    h. Uniformity And Standardization of Hundies
    i. Repayment facilities of bills.
5. Development of banking operations: The development of banking operations is essential for the development or money market. The -expansion of bank branches will increase the banking operations.. Money market will be developed on strong lines when credit facilities are made available in urban and rural areas, collection of savings, investment of mobilized savings, make available finance and short term finance without securities in the country.
6. Establishment of Clearing Houses: Clearing Houses should be established to take advantage of banking facilities. The branches of banks are being expanded on the one hand but the numbers of clearing houses are very few. It takes time in getting the payment through commercial bills.
7. Facilities of money transfer: There should be facilities of money transfer from financial institutions on the minimum cost in order to develop organized money market. The lower the cost of money transfer the more will be the demand for finance and trade and industries will be given sufficient funds.
8. Expansion of money market: The money market facilities are limited to large cities and towns only. These facilities are to be extended throughout the country. Banking facilities, clearing houses facilities, acceptance houses' facilities and facilities of discounting of bills should be extended to small towns and cities to develop the money market.
9. Development of secondary market: The development of money market presupposes the development of secondary market. Securities are bought and sold in secondary markets. Such securities are of long duration. When secondary market is developed the money market will automatically develop.

10. Control on chit fund companies: Chit fund companies carry a big business in private sector. These companies attract the members to pay various types of incentives but after sonic time these companies are closed and the amount collected are taken away and there is no whereabouts of such companies. A new act should be enacted by the RBI to control such chit fund companies in order to develop money market.

Thus the above suggestions will go a long way in the development of money market in our country.

Composition of money market

a. **Call money market-** Call money market is a segment of the money market where scheduled commercial banks lend borrow on call or at short notice (1 day to 14 days) to manage the day to day surplus & deficits in their cash flows. It is primarily centralized in Mumbai with sub markets in Delhi, Kolkata, Chennai, Ahmedabad. Current and expected interest rates on call money are the basic rates to which other money markets and to some extent the government securities market are anchored. The participants in the markets are commercial banks, co-operative banks & primary dealers who can borrow and lend funds. Larger mutual funds promoted by nationalized banks, private sector mutual funds and all India financial institutions can participate in market as lender only.
b. **Commercial bill market -** Bills of exchange are drawn by the seller on the buyer for the value of the goods delivered by him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. One of the methods used by the bank for providing credit to customers is by discounting commercial bills at a negotiated discount rate. This discounted bills can be rediscounted by the bank in the commercial bills Discount Market. The rate of discount was governed by a directive from the RBI, which had stipulated a ceiling rate of 11.5%. The proportion of bills to total bank rate declined from 10.5% in 1978 to 4.8% in Feb 1991.
c. **Acceptance Market-** refers to the market where trade bills are accepted by financial intermediaries. All trade bills cannot be discount easily because the parties to the bills may not be financially sound. In such case the bills are accepted by the financial intermediaries sot that the bills earn a good name and reputation and then such bills can be readily discounted anywhere.
d. **Treasury bill market-** A TB is basically an instrument of short term borrowing by the government of India. TBs are issued in lots of Rs. 25000 for 14 days and 91 days and Rs. 100,000 for 364 days TBs. TBs are approved securities for SLR. Features of TBs are:
   1) Govt. contribution to the money market
   2) Mop up short term funds in the money market
   3) Sold through auctions
   4) Discount rate is market driven and
   5) Focal point for monetary policy.

   There are two types of bills: (i) Ordinary/ regular bills- issued to the public/ financial institutions. These are freely marketable & can freely bought & sold. (ii) Adhocs bills are always issued in favour of the RBI only. They are not marketable in India. However the holders of these bills can always sell them back to the RBI.
e. **Certificates of Deposits Market –** Certificates of Deposits are marketable receipts in bearer or registered form of funds deposited in a bank for a specified period at a specified rate of interest. They are different from the fixed deposits in the sense that they are freely transferable, can be sold to someone else and can be traded on the secondary market. They are liquid and riskless in terms of default of payment of interest and principle.
f. **Commercial Paper Market –** Commercial paper (CP) is a short-term instrument of raising funds by corporate. It is essentially a sort of unsecured promissory note sold by the issuer to a banker or a security house. Maturity of his instrument is flexible

depending upon needs of borrower and lender. Highly rated corporate, capable of raising fund at lower the banks lending rates, issue such papers.

Acceptance House

In London, there are specialist firms called acceptance houses which accepts bills drawn by traders and import greater marketability. In India there are no acceptance houses. The commercial banks undertake the acceptance business to some extent.

Discount houses

In some countries there are some financial intermediaries who specialist in the filed of discounting. For eg, In London money market there are specialized institution called discount houses which specializes only in the field of discounting bills. Such institutions are conspicuously absent in India. Hence commercial banks in India have to undertake the work of discounting. However, the DFHI has been establishes to activate this market.

Recent Development in Money Market

(i) Debt. Securitization : The buzzword in the money market is now debt securitization which refers to converting retail loans into whole sale loan and their reconverting into ret loans. The philosophy behind the arrangement is that an individual body cannot go on lending sizable amount for about a longer period continuously but if the loan amount is divided in small pieces and made transferable like negotiable instruments in the secondary market, it becomes easy to finance large projects having long gestation period. The Industrial Credit and Investment Corporation of India (ICICI) as well as other private financial companies have been trying similar deals for lease rentals. Some finance companies are also following the same route for financing promoters contribution for projects. The HDFC has entered into an agreement with ILFS to securities its individual housing loan portfolio to the extent of Rs. 100 crores.

In India beginning was made to a limited extent, by introducing Inter-bank Participations (IBPs). In October, 1988, two types of IBPs were introduced (i) a risk bearing IBP with 91-180 days maturities, and (ii) non-risk bearing IBP with maturities upto 90 days.

(ii) Money Market Mutual Funds (MMMFs) : One of the recent development in the sphere of money market is the establishment of Money Market Mutual Funds, the guidelines of which have been made public by the Reserve Bank of India. Money Market Mutual Funds (MMMFs) can be set up by the banks and public financial institutions. There can also be Money Market Deposit Accounts (MMDAs). The limit for raising resources under the MMMF scheme should not exceed 2% of the sponsoring bank's fortnightly average aggregate deposits during 1991-92. If the limit is less than Rs. 50 crores for any bank, it may join with some other bank and jointly set up MMMF. In the case of public financial institutions, the limit should not exceed 2% of the long term domestic borrowings as indicated in the latest available audited balance sheets.

(iii) Repurchase Options (Repo.) and Ready forward (RF) contracts : Under this transactions the borrower places with lender certain acceptable securities against funds received and agrees to reverse this transaction on a pre-determined future date at agreed interest cost. Generally repo-transactions are for minimum period of 14 days and maximum period of 1 year. The transactions can be undertaken by commercial banks, financial institutions, brokers, DFHl) Nand Kami panel set up for examining transactions in PSLJ bonds and UTI units have recognised the importance of this instrument as a money market instrument and recommended its re-introduction. Repo or ready-forward deal, is a sale of RBI- approved securities (or repo securities) by a bank to another bank, or STCI or DFHI, with a commitment to repurchase the same at an agreed future date.