

FINANCIAL



MARKETS AND INSTITUTIONS

DR. PARAMJEET KAUR



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**Financial Markets
and
Institutions**

Dedicated to

'Arvinder, my husband, my friend and fellow traveller'

Financial Markets and Institutions

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Preface

The International Financial System has been through a process of rapid change and continues to evolve. The primary driving forces behind such changes have been the information technology and liberalisation measures adopted in countries across the globe. The Indian Financial System has also evolved continuously since the economic reforms were initiated and has undergone profound transformation over the last three decades from a highly fragmented, underdeveloped system to a deeper, more mature, and diversified one. Economic reforms have not only helped in raising the growth rate of the economy, but also in avoiding crisis, promoting greater efficiency and have imparted resilience to the financial system.

There has been substantial theoretical and empirical work on the role of financial markets in fostering economic growth, economic development and economic stability. The process of economic development is generally accompanied by a parallel growth in the financial system. A growing body of evidence suggests that countries with sound and efficient financial systems – banks, equity markets, bond markets, and foreign exchange markets, facilitate channeling of capital to its most productive uses, and thus, tend to grow faster over longer periods of time. This book aims to provide an understanding of the working of the financial system and the role of financial institutions and markets in the economy, focusing in particular on contemporary developments in the Indian context. Further, the book explores various conceptual additions to the new syllabus for this paper introduced in the current year, *viz.*, Financial Stability and its Indicators, Global Financial Crisis, Indicators of Financial Development used by the World Bank, Integration of Financial Markets, to name a few.

The book derives its primary impetus from a very specific need of the present Undergraduate student of Commerce and Finance as experienced in the Classroom. While there are books that offer extensive coverage of relevant areas, they are voluminous and dated. As such, they do not carry sufficient representation of contemporary scenarios. On the other hand, more recent publications on the subject, while more concrete and updated, do not provide in-depth analysis and theoretical exposure of the key areas. The present text aims at bridging this precise gap by connecting theoretical understanding with recent and contemporary developments in the financial system particularly, within the Indian context.

This book is designed to cater to the learning requirements of Undergraduate Courses in Commerce – B.Com. (Hons.), B.Com. and BA (Finance) in particular and similar courses in Finance offered by other institutions/universities. The book is exclusively based on new UGCF syllabus prescribed under the ‘New Education Policy, 2022’ for the students of B.Com. (Hons.), University of Delhi. Particular attention has been paid to the structuring of chapters such that they are in consonance with syllabus content for the Undergraduate Curriculum Framework (UGCF) – 2022 based on National Education Policy (NEP) – 2020.



This book's subject matter has been presented cohesively across 15 Chapters, which are divided into five parts. Unit 1 of the book consists of two chapters; Chapter one introduces the concept of the financial system and explains its structure, organisation and how it is linked to economic growth. It also clarifies the concepts of financial intermediation and financial development, while introducing various indicators of financial development as developed by the World Bank. Chapter 2 presents a historical perspective of the Indian financial system in the pre-reform era and gives a detailed account of the reforms and developments that have taken place since 1991 with a focus on recent reforms undertaken during the last decade.

Unit 2 has two chapters that deal with the financial markets. Chapter 3 covers the money market which is the most important component of the financial system comprising the banking system. As regulators of the money market, the main role of Central Banks is to ensure smooth functioning of the money market. While Chapter 3 discusses in detail the structure, significance, participants and instruments of money market, chapter 4 presents the role of the RBI in the regulation and functioning of money market in India with a specific reference to the role of Monetary Policy Committee (MPC) in India.

Unit 3 of the book focuses on capital markets and comprises chapters 5 to 9. These provide an in-depth view of the different elements of the capital market such as the primary or New Issue Market, Secondary markets, Debt market and explain various aspects related to these markets such as methods of flotation, the role of stock exchanges and major stock indices, capital market instruments, government securities market, to name a few. The role of SEBI with specific emphasis on investor protection is also discussed in chapter 9.

Unit 4 which consists of chapters 10 to 14, deals with institutional aspects of the financial system. Chapters 10 provides an in-depth coverage of the concept, classification and role of the commercial banking system in India. Chapter 11 has been dedicated entirely to a discussion of recent developments in the field of commercial banking in India which includes new initiatives and reforms, the role of technology in banking, the issues of asset-liability management and that of Non-Performing Assets (NPAs). Chapters 12, 13 and 14 delve into the concept and functioning of other non-banking financial institutions, *viz.*, Insurance sector, Mutual Funds and NBFCs. Recent developments and contemporary issues in the areas of Insurance, Mutual funds and NBFCs have been addressed in these chapters.

Lastly, Unit 5 of the book includes chapter fifteen which discusses the concept and importance of financial stability in an economy and its lack thereof which may lead to a financial crisis. It also discusses various indicators which are used to measure financial stability. The chapter also describes some of the major financial crises [with a specific focus on the global financial crisis (2008)], their causes and the policy measures undertaken by policy makers to mitigate the adverse impact of such crises.

I hope that the book will serve as a valuable resource for both students and teachers. I look forward to the suggestions and feedback for the improvement of future editions.

New Delhi

Dr. Paramjeet Kaur

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The book would not have been possible without the invaluable contribution from several people. The original impetus for writing this book came from my students' need for it. They asked me to publish my lectures and of course, my interaction with them over the years has gone on to add to the lived quality of the book.

I would like to express my gratitude to Prof. Jaswinder Singh, Principal, SGTB Khalsa College, for his constant guidance and encouragement. He has also helped build an academic ethos in the college which stimulates us.

I owe a very special thanks to Ms. Anusha Goel, Assistant Professor from Shaheed Sukhdev Singh College of Business Studies for providing me substantial inputs for the chapter on Commercial Banks.

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I owe a lot to my husband, Arvinder S. Sachdeva, a fine scholar himself, but self-effacing, he gave me the freedom to think and work independently but supported me in all kinds of way. He was always willing to go through my drafts and provide his suggestions. Thanks are also due to my children Himani and Gagandeep. Part of the academia themselves, the value they give to my work is a reward in itself. Last but not the least, I am also indebted to my family and friends who have been a source of immense energy and provided me the much needed emotional support and strength whenever I needed it.

Dr. Paramjeet Kaur

Syllabus

Financial Markets and Institutions

BCH: DSE – 3.2

Objective: The course aims to provide students an overview of the financial system to help them understand the role of financial institutions and the financial markets.

Learning Outcomes: After completion of the course, learners will be able to:

1. describe the meaning, components and functions of a financial system.
2. interpret different financial systems and describe how they operate.
3. analyse theoretical concepts underlying money and capital markets.
4. describe the evolution of the Indian financial system.
5. assess information related to financial markets and institutions in a global context with special emphasis on financial stability.

Unit 1: Introduction

An introduction to financial system – components, inter-linkages between financial system and economic development, financial intermediation, indicators of financial development (World Bank); capital allocation – financial institutions *vis-a-vis* financial markets; evolution of Indian financial system since 1951; recent reforms and developments in Indian financial system.

Unit 2: Financial Markets I: Money Markets

Financial markets – integration of Indian financial markets with global financial markets; money market – functions, organisations and participants; money market instruments; role of central bank in money market; role of Reserve Bank of India in Indian money market; Fixed Income Money Market and Derivative Association of India (FIMMDA).

Unit 3: Financial Markets II: Capital Markets

Capital Markets – introduction, components, role and functions; equity market – methods of issue; debt market-concept, significance and classification; capital market instruments; raising funds from global financial markets; primary and secondary markets – concept, similarities, differences; stock exchanges in India – NSE, BSE; Stock Indices: concept and construction, major stock indices – global (including Dow Jones and NASDAQ) and Indian (NIFTY and BSE-SENSEX); concept of DEMAT account and depositories (NSDL, CDSL); SEBI and investor protection.

Unit 4: Financial Institutions

Commercial banking – introduction, classification, role, asset liability management, non-performing assets; role of technology in banking sector; financial inclusion, recent developments in banking



including restructuring, privatisation, MUDRA financing; Insurance – life and non-life insurance companies in India: public and private; Mutual Funds – introduction and their role in capital market development, types of mutual fund schemes (open ended vs close ended, equity, debt, hybrid schemes and Exchange Traded Funds (ETFs); Non-banking Financial Companies (NBFCs) – role and types; private equity, venture capital and hedge funds.

Unit 5: Financial Stability

Financial stability – importance and indicators (World Bank, IMF, RBI); understanding financial crisis – causes and policy response; global financial crisis (2008); emerging challenges to financial stability.

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About the Book

This book on Financial Markets and Institutions provides a comprehensive coverage of the relevant areas which are part of the syllabus for paper on Financial Markets and Institutions for Semester III of B. Com. (Hons.) of University of Delhi. The book attempts to provide an in-depth analysis and theoretical exposure of the key areas to fill critical gaps in the learning needs of the present Undergraduate Commerce student, by bringing together a theoretical perspective with the recent and contemporary developments in the Indian Financial System. The book addresses many of the recent conceptual additions as introduced in the Undergraduate Curriculum Framework (UGCF)-2022 based on NEP-2020 for B. Com. (Hons.) and B. Com. The book primarily serves as a textbook but may also be used as reference book for the postgraduate courses as well as for courses such as B.A. (Finance), BMS, BME, MBA, and other professional courses taught at different institutions and universities.

Salient Features

- The book explores various conceptual additions introduced in the current syllabus on 'Financial Markets and Institutions' based on the current UGCF course (NEP) syllabus.
- Focuses on keeping the contents of the book current and relevant. Discusses the recent and developments, particularly in Indian perspective.
- Provides an in-depth theoretical knowledge and analysis of the financial markets and institutions from the perspective of contemporary developments.
- The book is written in a lucid, simple and engaging manner to provide a wide perspective of the concept of financial system to the students.
- Each chapter ends with a comprehensive summary of the chapter which helps the student to glance through the contents of the chapter.
- It incorporates the theoretical questions as well as the questions that have appeared in the recent question papers of Delhi University.
- An outline of the chapter is listed at the beginning of each chapter so as to convey the learning outcome of each chapter.
- The different chapters have been written keeping in view the current course requirement of the students for B. Com. Hons. and accordingly, the chapters follow the sequence given in the syllabus.

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