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# INDIAN FINANCIAL SYSTEM: HISTORICAL IMPLICATION AND MODERN DEVELOPMENT

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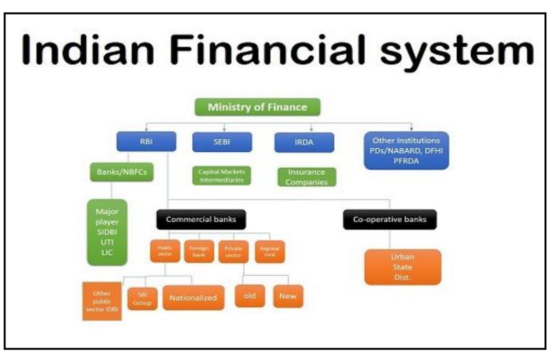
## ABSTRACT

*A Financial system (within the scope of finance) could be a system that permits the exchange of funds between lenders, investors, and borrowers. Money systems operate at national, global, and firm-specific levels. They include advanced, closely connected services, markets, associated establishments supposed to supply a Financial and regular linkage between investors and depositors. Money, credit, and finance area unit used as media of exchange in money systems. They function a medium of acknowledged worth that product and services are often changed as another to bartering. A contemporary financial system could embody banks (operated by the govt or personal sector), money markets, money instruments, and money services. Money systems enable funds to be allotted, invested, or rapt between financial sectors. They allow people and firms to share the associated risks.*

**KEY WORDS:** *Financial system , closely connected services, markets.*

## INTRODUCTION TO FINANCIAL SYSTEM

The Financial scene within the post independence amount has seen an ocean change; the tip result being that the economy has created huge progress in various fields. There has been a quantitative enlargement further as diversification of financial activities. The experiences of the Nineteen Eighties have diode to the conclusion that to get all the advantages of larger reliance on voluntary, market-based decision-making, Bharat wants financial money systems. The national economy is probably the foremost necessary institutional and useful vehicle for financial transformation. Finance could be a bridge between this and also the future and whether or not it's the mobilization of savings or their Financial, effective and equitable allocation for investment, it's the success with that the national economy performs its functions that sets the pace for the accomplishment of broader national objectives.



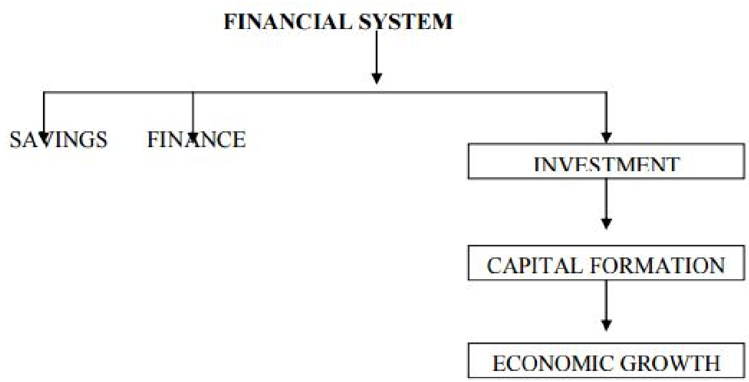

## DEFINITION:

The term financial system is a set of inter-related activities/services working together to achieve some predetermined purpose or goal. It includes different markets, the institutions, instruments, services and mechanisms which influence the generation of savings, investment capital formation and growth.

Van Horne defined the financial system as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users either for investment in real assets or for consumption. Christy has opined that the objective of the financial system is to "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth."

From the above definitions, it may be said that the primary function of the financial system is the mobilisation of savings, their distribution for industrial investment and stimulating capital formation to accelerate the process of financial growth.




## OVERVIEW

The Indian financial system can be broadly classified into the formal (organized) financial system and the informal (unorganized) financial system. The formal financial system comes under the purview of the Ministry of Finance (MOF) Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and other regulatory bodies. The informal financial system consists of:

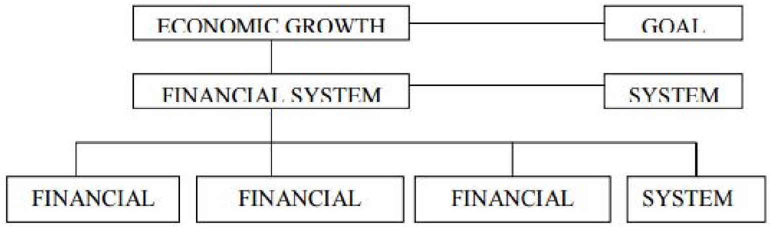
(i) Individual money lenders such as neighbors, relatives, land lords, traders, store owners and so on.

(ii) Groups of persons operating as funds or 'associations'. These groups function under a system of their own rules.

(iii) Partnership firms consisting of local brokers, pawn brokers and non banking financial intermediaries such as finance, investment, and chit fund companies. In India the spread of banking in rural areas has helped in enlarging the scope of the formal financial system.

## The Concept of the Financial System

The process of savings, finance and investment involves monetary establishments, markets, instruments and services. Above all, oversight management and regulation square measure equally vital. Thus, monetary management is associate degree integral a part of the financial system. On the premise of the empirical proof, Goldsmith aforementioned that "... a case for the hypothesis that the separation of the functions of savings and investment that is formed doable by the introduction instruments still as enlargement of the vary of Financial assets that follows from the creation of Financial establishments increase the potency of investments and lift the quantitative relation of capital formation to national production and financial activities and thru these 2 channels increase the speed of growth……"




## Inter-relationship in the Financial System

A national economy provides services that square measure essential in an exceedingly fashionable economy. The utilization of a stable, wide accepted medium of exchange reduces the prices of transactions. It facilitates trade and, therefore, specialization in production. Monetary assets with engaging yield, liquidity and risk characteristics encourage saving in monetary kind. By evaluating different investments and observation the activities of borrowers, monetary intermediaries increase the potency of resource use. Access to a spread of monetary instruments permits Associate in Nursing Financial agent to pool, value and exchange risks within the markets. Trade, the financial use of resources, saving and risk taking square measure the cornerstones of a growing economy. In fact, the country might build this possible with the active support of the national economy. The national economy has been known because the most catalyzing agent for growth of the economy, creating it one among the key inputs of development

## The Organization of the Financial System in India

The Indian Financial system is generally classified into 2 broad groups: i) organized sector and (ii) unorganized sector. "The Financial system is additionally divided into users of financial services and suppliers. Monetary establishments sell their services to households, businesses and government. They're the users of the monetary services. The boundaries between these sectors don't seem to be perpetually clear cut. Within the case of suppliers of financial services, though monetary systems take issue from country to country, there are several similarities.

(i) Central bank
(ii) Banks
(iii) Financial institutions
(iv) Money and capital markets and
(v) Informal financial enterprises

i) Organized Indian Financial System

The organized financial system includes of a formidable network of banks, different monetary and investment establishments and a spread of monetary instruments, that along perform in fairly developed capital and cash markets. Short funds square measure primarily provided by the business and cooperative banking structure. Nine-tenth of such banking business is managed by twenty-eight leading banks that square measure within the public sector. Additionally to business banks, there's the network of cooperative banks and exploitation banks at state, district and block levels. With around two-third share within the total assets within the national economy, banks play a crucial role. Of late, Indian banks have conjointly diversified into areas like merchandiser banking, mutual funds, leasing and resolving. The unorganized national economy includes the subsequent sub-systems:

1. Banking system
2. Cooperative system
3. Development Banking system

## ii) Unorganized Financial System

On the other hand, the unorganized financial system contains of comparatively less controlled moneylenders, endemic bankers, disposal pawn brokers, landlords, traders etc. This part of the economic system isn't directly amenable to regulate by the depository financial institution of Republic of India (RBI). There are a unit a bunch of monetary corporations, investment corporations, account funds etc., that also are not regulated by the run or the govt. in an exceedingly systematic manner. However, additionally ruled by rules and rules and are, thus inside the orbit of the financial authorities.

## CONCLUSION

As one appearance back at the last six years of reforms, it's evident that Asian country has undertaken monetary sector reforms at a leisurely pace which there's an oversized unfinished agenda of reforms during this sector (Varna, 1996b). At constant time, it's true that Asian country has avoided the monetary sector issues that overrun area within the eighties and are try East Asia nowadays. It’s tempting (and maybe fashionable) to adopt a posture of contented satisfaction and purpose to East Asia as a vindication of the slow pace of relaxation in Asian country. It’s but be a slip-up if Indian corporate allowed them to be lulled into complacence. East Asia has woke up USA to the risks that arise from a mixture of high leverage within the company sector, poor company governance, associate degree implicit currency peg and therefore the ensuing overvaluation of the currency, high dependence on external borrowings, a weak banking industry and widespread implicit guarantees by the govt.. although several of those factors are gift in Asian country too, they need been much more muted than in East Asia, and Asian country has so return to be seen as less vulnerable. Additional significantly, in depth capital controls have meant that Asian country is a smaller amount exposed to international monetary markets. Some analysts currently seem to assume that this decent factor. However, we have a tendency to should not forget that monetary markets are solely the messengers of dangerous news which by cutting ourselves removed from these messengers, we have a tendency to don't get obviate the dangerous news itself. East Asia ought to be seen as a warning for the Indian company sector to pursue additional prudent and property monetary policies.

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