B.Com. Hons. in Accounting
2nd Semester
BCOMHFINGE201: Money Market

Unit – 3: Structure of Money Market

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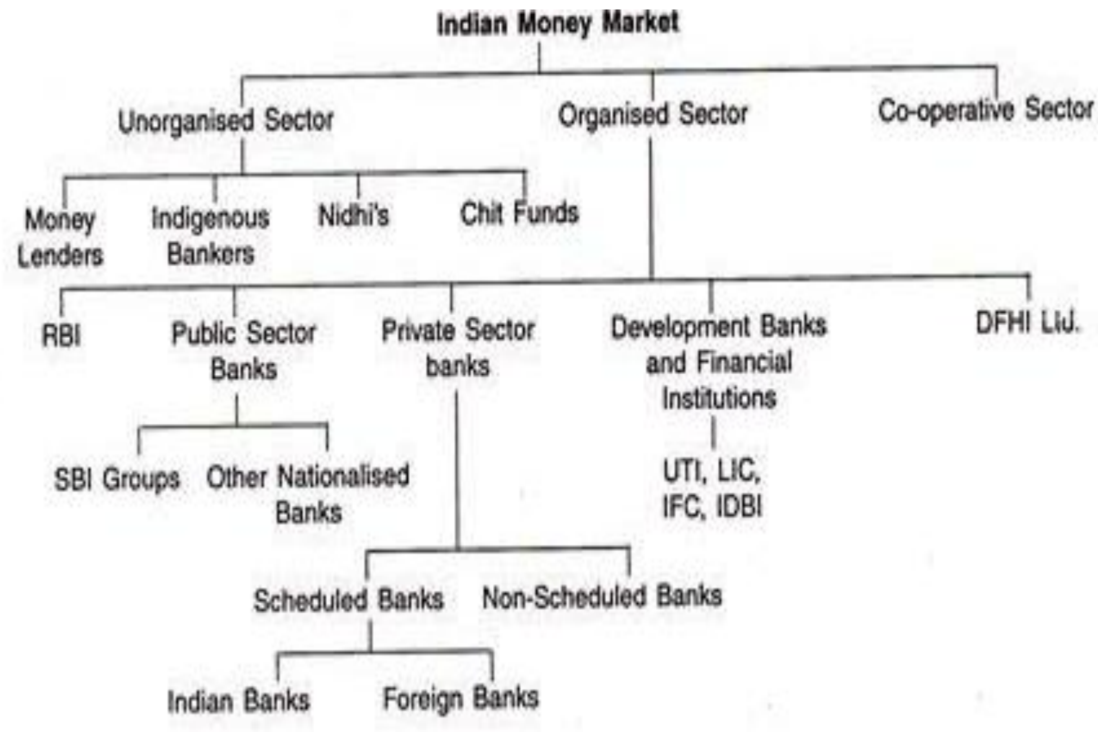
Discuss the Structure & Functions of Money Market in India:

Indian money market is divided into organized and unorganized segments. Unorganized market is old Indigenous market mainly made of indigenous bankers, money lenders etc. Organized market is that part which comes under the regulatory purview of RBI and SEBI. The nature of the money market transactions is such that they are large in amount and high in volume. Thus, the entire market is dominated by small number of large players. At the same time, the money market in India is yet underdeveloped. The key players in the organized money market include Governments (Central and State), Discount and Finance House of India (DFHI), Mutual Funds, Corporate, Commercial / Cooperative Banks, Public Sector Undertakings (PSUs), Insurance Companies and Financial Institutions and Non-Banking Financial Companies (NBFCs).

below shows the structure of Indian money market :



Organised Sector of Indian Money Market:

The organised segments of the Indian money market is composed of the Reserve Bank of India (RBI), the State Bank of India, Commercial banks, Co-operative banks, foreign banks,

finance corporations and the Discount or Finance House of India Limited. The segment of Indian money market is quite integrated and well organised.
Mumbai, Kolkata, Chennai, Delhi, Bangalore and Ahmedabad are the leading centres of the organised sectors of the Indian money market. The Mumbai money market is a well organised, having head offices of the RBI and different commercial banks, two leading well developed stock exchanges, the bullion exchange and fairly organised market for Government securities. All these have placed the Mumbai money market at par with New York money market of USA and London money market of England.

Reserve Bank of India:

Reserve Bank of India (RBI) is the Central Bank of the country. Role of RBI differs from other banks since it does not get engaged in day to day retail banking; does not do micro or macro regular financing. On the contrary, it is the Bankers' Bank and formulates monetary guidelines and policies which are to be followed by all the banks operating in the country.
The Reserve Bank of India was established in 1935 with the provision of Reserve Bank of India Act, 1934. Till 1949 RBI was privately owned and was nationalised in 1949. Since then RBI is fully owned by the Government of India.
Role of RBI:
Reserve Bank of India (RBI) is India's Central bank. It plays multi-facet role by executing multiple functions such as overseeing monetary policy, issuing currency, managing foreign exchange, working as a bank of government and as banker of scheduled commercial banks, among others. It also works for overall economic growth of the country.
The preamble of the Reserve Bank of India describes its main functions as 'to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage'.

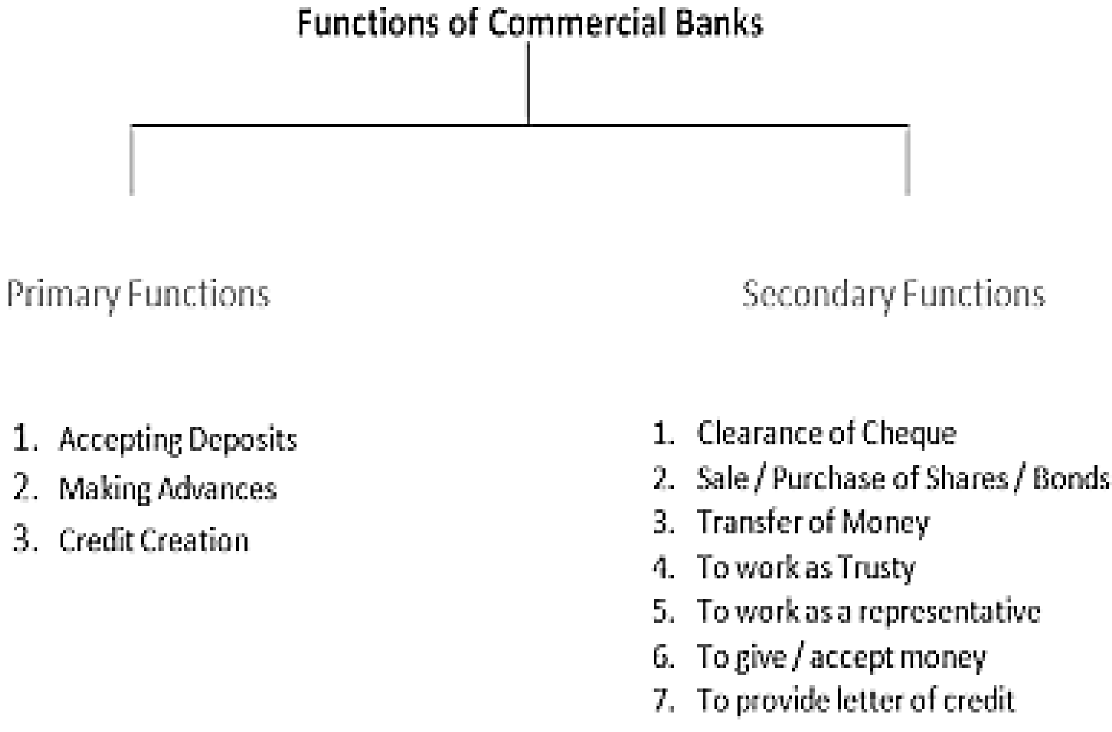
Discount And Finance House Of India (DFHI)

The DFHI was set up in April 1988 by the Reserve Bank of India to help develop the money market in India. Money market refers to an activity in which financial transactions take place in short-term financial assets which are close substitutes for money.
The instru-ments traded in the money market will have maturity period less than a year. Some of such assets are call money (overnight money), notice money (1 to 14 days), inter-bank term de-posits/loans (15 days and over), commercial bills and treasury bills, certificate of deposits, etc.
With a view to impart increased liquidity in the money market instruments the DFHI was set up. It would deal with treasury bills of different maturities and rediscount short- term commercial bills.
DHFI operates with emphasis on high turnover of money market assets and provides two way motes for funds (bid and offer) with a thin spread. DHFI participates both as lender and borrower in the money market since 28th July 1988.

Commercial Banks:

Commercial banks are the most important components of the whole banking system.
A commercial bank is a profit-based financial institution that grants loans, accepts deposits, and offers other financial services, such as overdraft facilities and electronic transfer of funds.
Commercial banks are of three types, which are as follows:
(a) Public Sector Banks:Refer to a type of commercial banks that are nationalized by the government of a country. In public sector banks, the major stake is held by the government. In India, public sector banks operate under the guidelines of Reserve Bank of India (RBI),

which is the central bank. Some of the Indian public sector banks are State Bank of India (SBI), Corporation Bank, Bank of Baroda, Dena Bank, and Punjab National Bank.
(b) Private Sector Banks:Refer to a kind of commercial banks in which major part of share capital is held by private businesses and individuals. These banks are registered as companies with limited liability. Some of the Indian private sector banks are Vysya Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, and Housing Development Finance Corporation (HDFC) Bank.
(c) Foreign Banks:Refer to commercial banks that are headquartered in a foreign country, but operate branches in different countries. Some of the foreign banks operating in India are Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard & Chartered Bank, and Grindlay's Bank. In India, since financial reforms of 1991, there is a rapid increase in the number of foreign banks. Commercial banks mark significant importance in the economic development of a country as well as serving the financial requirements of the general public.
<u>Functions of Commercial Banks:</u>
Commercial banks are institutions that conduct business for profit motive by accepting public deposits for various investment purposes.
The functions of commercial banks are broadly classified into primary functions and secondary functions.



The functions of commercial banks (as shown in Figure) are discussed as follows:

Primary Functions of Commercial Banks
Commercial Banks performs various primary functions some of them are given below

1. **Accepting Deposits** : Commercial bank accepts various types of deposits from public especially from its clients. It includes saving account deposits, recurring account deposits, fixed deposits, etc. These deposits are payable after a certain time period.
2. **Making Advances** : The commercial banks provide loans and advances of various forms. It includes an over draft facility, cash credit, bill discounting, etc. They also give demand and demand and term loans to all types of clients against proper security.
3. **Credit creation** : It is most significant function of the commercial banks. While sanctioning a loan to a customer, a bank does not provide cash to the borrower Instead it opens a deposit account from where the borrower can withdraw. In other words while sanctioning a loan a bank automatically creates deposits. This is known as a credit creation from commercial bank.

Secondary Functions of Commercial Banks

Along with the primary functions each commercial bank has to perform several secondary functions too. It includes many agency functions or general utility functions. The secondary functions of commercial banks can be divided into agency functions and utility functions.

A. **Agency Functions** : Various agency functions of commercial banks are
   - To collect and clear cheque, dividends and interest warrant.
   - To make payment of rent, insurance premium, etc.
   - To deal in foreign exchange transactions.
   - To purchase and sell securities.
   - To act as trusty, attorney, correspondent and executor.
   - To accept tax proceeds and tax returns.

B. **General Utility Functions** : The general utility functions of the commercial banks include
   - To provide safety locker facility to customers.
   - To provide money transfer facility.
   - To issue traveller'scheque.
   - To act as referees.
   - To accept various bills for payment e.g phone bills, gas bills, water bills, etc.
   - To provide merchant banking facility.
   - To provide various cards such as credit cards, debit cards, Smart cards, etc.

Financial And Investment Institutions:

A financial institution (FI) is a company engaged in the business of dealing with financial and monetary transactions, such as deposits, loans, investments and currency exchange. Financial institutions encompass a broad range of business operations within the financial services sector, including banks, trust companies, insurance companies, brokerage firms and investment dealers. Virtually everyone living in a developed economy has an ongoing or at least periodic need for the services of financial institutions.

Examples:

- Finance Corporation of India (IFCI)
- Industrial Credit and Investment Corporation of India (ICICI)
- State Financial Corporations (SFCs)
- State Industrial Development Corporations (SIDC’S)
- Industrial Development Bank of India (IDBI)
- Industrial Investment Bank of India (IIBIL)
- Unit Trust of India (UTI)
- Small Industries Development Bank of India (SIDBI)

By an investment company, we generally mean a company, which is responsible for issuing securities as well as is primarily involved in the investment business. They normally invest the money received from their investors and every investor shares the profit or the losses that is proportionate to the interest of the investor in that company. The performances of such companies are mostly based on the performance of the different kinds of assets and the securities, which they own.

Examples:

- Bajaj Allianz General Insurance Company Limited
- Barclays Capital
- Infrastructure Development Finance Company Limited
- Larsen & Toubro Mutual Fund
- Peerless General Finance & Investment
- Tata Investment Corporation

Corporate Finance

Corporate finance deals with the capital structure of a corporation including its funding and the actions management take to increase the value of the company. Corporate finance also includes the tools and analysis utilized to prioritize and distribute financial resources.

The ultimate purpose of corporate finance is to maximize the value of a business through planning and implementing management resources while balancing risk and profitability.

Important Activites that Govern Corporate Finance:

1. Investments & Capital Budgeting

Investing and capital budgeting includes planning where to place the company's long-term capital assets in order to generate the highest risk-adjusted returns. This mainly consists of deciding whether or not to pursue an investment opportunity through extensive financial analysis.

2. Capital Financing

This core activity includes decisions on how to optimally finance the capital investments (discussed above) through the business' equity, debt, or a mix of both. Long-term funding for major capital expenditures or investments may be obtained from selling company stocks or issuing debt securities in the market through investment banks.

3. Dividends & Return of Capital

This activity requires corporate managers to decide whether to retain a business's excess earnings for future investments and operational requirements or to distribute the earnings to shareholders in the form of dividends or share buybacks.

Unorganised Sector of Indian Money Market:

Unorganised segment of the Indian money market is composed of unregulated non-bank ©, indigenous bankers and money lenders which exist even in the small towns and big cities. Their lending activities are mostly restricted to small towns and villages. The persons who normally borrow from this unorganised sector include farmers, artisans small traders and small scale producers who do not have any access to modern banks.

The following are some of the constituents of unorganised money market in India.

(i) Indigenous Bankers:

Indigenous bankers include those individuals and private firms which are engaged in receiving deposits and giving loans and thereby acting like a mini bank. Their activities are not at all regulated. During the ancient and medieval periods, these indigenous bankers were very active. But with the growth of modern banking, particularly after the advent of British, the business of the indigenous bankers received a setback.

Moreover, with the growth of commercial banks and co-operative banks the area of operations of indigenous bankers has again contracted further. Even today, a few thousands of indigenous bankers are still operating in the western and southern parts of the country and engaging themselves in the traditional banking business.

Indigenous bankers are classified into four main sub groups, i.e., Gujarati Shroffs, Multani-or ShikarpuriShroffs, Chettiars and Marwari, Kayast. Gujarati Shroffs are mostly operating in Mumbai, Kolkata and in industrial and trading cities of Gujarat. The Multani or ShikarpuriShroffs are operating mainly in Mumbai and Chennai. The Chettiars are mostly found in the South.

The Marwari Shroffs are mostly active in Mumbai, Kolkata, tea gardens of Assam and also in different other parts of North-East India. Among the four aforesaid groups, the Gujarati indigenous bankers are considered as the most powerful groups in respect of its volume of business.

The indigenous bankers are mostly engaged in both banking and non-banking business which they do not want to separate. Their lending operations remain mostly unregulated and unsupervised. They charge high rate of interest and they are not influenced by bank rate policy of the Reserve Bank of India.

(ii) Unregulated Non-Bank Financial Intermediaries:

There are different types of unregulated non-bank financial intermediaries in India. They are mostly constituted by loan or finance companies, chit funds and 'nidhis'. A good number of finance companies in India are engaged in collecting substantial amount of funds in the form of deposits, borrowings and other receipts.

They normally give loans to wholesale traders, relailers, artisans, and different self-employed persons at a high rate of interest ranging between 36 to 48 per cent.

There are various types of chit funds in India. They are doing business in almost all the states but the major portion of their business is concentrated in Tamil Nadu and Kerala. Moreover, there are 'nidhis' operating in South India which are a kind of mutual benefit funds restricted to its members.

(iii) Moneylenders:

Moneylenders are advancing loans to small borrowers like marginal and small farmers, agricultural labourers, artisans, factory and mine workers, low paid staffs, small traders etc. at very high rates of interest and also adopt various malpractices for manipulating loan records of these poor borrowers.

There are broadly three types of moneylenders:

(i) Professional moneylenders dealing solely with money lending;

(ii) Itinerant moneylenders such as Kabulis and Pathans and

(iii) Non-professional moneylenders.

The area of operation of the moneylenders is very much localised and their methods of operation is also not uniform. The money lending operation of the moneylenders is totally unregulated and unsupervised which leads to worst exploitation of the small borrowers.

Moneylenders have become a necessary evil in the absence of sufficient institutional sources of credit to the poorer sections of society. Although various measures have been introduced to control the activities of moneylenders but due to lack of political will, these are not enforced, leading to a exploitation of small borrowers.

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