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A study about Financial Markets in India

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Abstract

An understanding of the organisational structure of markets for financial assets is vital for knowing the limitations and prospects in relation to efficiency, integration and stability. Financial markets in India comprise in the main, the credit market, the money market, the foreign exchange market, the debt market and the capital market . Recently, the derivatives market - OTC and exchange traded - has also emerged. With banks having already been allowed to undertake insurance business, bancassurance market is also likely to emerge in a big way. Most of the financial markets were characterised till the early 'nineties by controls over the pricing of financial assets, restrictions on flows or transactions, barriers to entry, low liquidity and high transaction costs. These characteristics came in the way of developments of the markets and allocative efficiency of resources channelled through them. The initiation of financial sector reforms in the early 'nineties was essentially to bring about a transformation in the structure, efficiency and stability of financial markets, as also an integration of the markets. Some of the important structural changes enabled by financial sector reforms relate to introduction of free pricing of financial assets in almost all segments, relaxation of quantitative restrictions, removal of barriers to entry, new methods of floatation/issuance of securities, increase in the number of instruments and enlarged participation, improvement in trading, clearing and settlement practices, improvement in the informational flows, transparency and disclosure practices, to name a few.

key words: organisational, financial, securities, markets etc.

Introduction

A financial market is a marketplace for financial products. Here buyers and sellers interact with each other. They trade in financial assets like equities, bonds, mutual funds, currencies, and derivatives. The price discovery of such financial assets is purely the play of demand and supply of the underlying assets in the market. Thus, the financial market acts as a bridge between those who have access money with those who are in deficit and in need of money. So, through financial market funds flows from suppliers to demander of the funds through the use of financial instruments. Now let us look at the different types of financial markets and their brief role.

Types of financial markets and their roles

Broadly speaking financial market can be subcategorized as following –

1. Stock exchanges,
2. Money market,

3. Bond market,
4. Foreign exchange, and
5. Interbank market

1. Stock exchanges

Stock exchange provides a facility for trading and investing in sport and future market. Instruments that are stocks, commodities, and currencies. Future and options of these instruments are the part of the future segment of the market. Options trading includes both put and call options. In Indian market not every instrument of spot market have their future and option counterpart. Very few future contracts are available and same with options contract. The next major issue with future and option market is that barring a few, there is an issue of liquidity and depth in these future and options contracts.

2. Money market

The money market in India is a marketplace for short duration funds requirements. The instruments of money markets have in general maturities that range from overnight to a year. Instruments include treasury bills, call money, commercial papers, certificate of deposits, repos, interest rate swaps, cash management bills and etc. Retailers do not have permission to buy and sell all money market instruments directly. They have options to do so through mutual funds, investing exclusively in such instruments.

Also, not all corporates, institutions and banks of all categories have permission to trade in all these instruments. Details of money market instruments in India and RBI guidelines can be found here in this RBI document.

3. Bond market

In India, the bond market is also known as debt market. Here, in the bond market along with government bonds, corporate bonds are also traded. Some mutual funds schemes also deal exclusively with bonds. So we can consider them as a subpart of Indian bond market. However, government bonds dominate Indian bond market. Comparing to other bond markets, government bonds markets are highly liquid.

Government bonds are either sovereign bonds or municipal bonds. All sovereign bonds are in INR denomination while municipal bonds are in both INR and foreign currency denomination. So far only one municipal bond in HDK (Hong Kong Dollar) is issued. In a similar way, corporate bonds are either in INR or foreign currency denomination. US Dollar, Singapore Dollar, and Euro-denominated corporate bonds are there in the market.

Indian corporates have issued these bonds in international markets to raise debt as Eurobonds, foreign bonds, quasi-debt instruments like FCCB’s (Foreign currency convertible bonds) and FRN’s (Floating Rate Notes).

Thus, Indian bond market has the following 5 subcategories –

1. Government bond market
2. Municipal bond market
3. Corporate bond market
4. Funding bond market
5. Mortgage-backed and collateral debt obligation bond market

4. Foreign exchange market

Foreign exchange market is also known as international currency market. Here in this market you can buy and sell international currencies. We also call it Forex market. This market gives the organizational framework for the participants. Participants of forex market include individuals, banks, firms, merchants, traders, and governments.

The FEMA (The Foreign Exchange Management Act, 1999) regulates Indian forex market. However, all interbank forex trading is regulated by FEDAI (the Foreign Exchange Dealers Association of India).

Interbank market

Interbank market is mainly for banks. Here banks exchanges and trades different foreign currencies with each other. It is, in fact, a subpart of foreign exchange market in India. There are three main parts of interbank markets –

1. Spot market
2. Forward market
3. SWIFT (The Society for Worldwide Interbank Financial Telecommunications)

Structure of Financial Markets in India

This is popularly referred to as financial intermediation and exists at the core of the Indian economy; bringing investors and businesses together in a symbiotic relationship. Here is what it consists of.

- **The Banking System**

Indian banking has a multi-tier structure. The Reserve Bank of India is the regulator of the banking system and the monetary authority. Its functions include licensing banks and regulation for a strong and stable banking system. RBI is the note-issuing authority and banker to the government and acts as a lender of last resort to the other banks. It also acts as a controller of credit in the monetary system. On the banking front there are PSU banks, private banks; cooperative banks, small finance banks etc. and they combine to define the Indian banking system.

- **Indian Securities Market**

The securities market provides an institutional framework for efficient flow of capital in the economy. Capital markets converts saving into investments for the investor and it converts business pedigree into funding for the businesses. This basic arrangement in the securities markets enables flow of capital from households to business, in a regulated institutionalised framework.

The securities market include equities, index futures, index options, stock futures, stock options, long term bonds, medium term bonds, short term bonds, money market securities, equity funds, debt funds, hybrid funds, structured products, REITS, INVITs etc

- **Indian Commodities Market**

Commodity market facilitates transactions between buyers and sellers of commodities. These commodities are broadly dividend into four categories viz. agricultural commodities, precious metals, industrial metals and energy products (oil and gas). Commodities can be traded in India in the spot market (for immediate delivery) or in the futures market (for delivery), or in the futures market (not for delivery) or in the options (so as to devolve into commodity futures). Commodity markets are essentially used by industries, traders, importer and exporters to hedge the commodity price risk

- **Foreign Exchange Market or Forex Market**

This is where the currencies are exchanged and there are traders, arbitrageurs, speculators and hedgers in these markets. Globally, the forex trading market is the largest compared to other asset classes. The growth of international trade made it necessary to be able to determine the relative value of currencies given the differences in their purchasing power. The need for exchanging one currency to another for settling trades in goods and services brought about foreign exchange risk and that created a robust forex market. India has had the rupee forward market offered by banks for a long time, but that is offered by banks only against actual exposure.

- **Indian Insurance Market**

Insurance business in India is regulated by the Insurance Regulatory and Development Authority (IRDA) of India. It regulates life and non-life insurance activities in India. Insurance is all about sharing of risk. Broadly, there are 3 sub categories in insurance viz. life insurance, non-life insurance and re-insurance. Insurance in India is still fairly underpenetrated. For long the insurance business was dominated by the government owned companies but that has changed over the last 20 years with the entry of private players.

- **Indian Pension Market**

Much of the Indian population is still outside the formal retirement benefit cover provided by the government and its associated organisations, and companies covered under the Employees

Provident Fund Organisation (EPFO). In provident fund contribution, a portion of the employers' contribution is earmarked to provide pension under the Employee Pension scheme. Some private companies may provide Superannuation plans and privately sponsored pension plans to their employees. The National Pension System (NPS) is a defined contribution pension scheme now applicable to government employees, where the employee and the government make matching contributions to a fund of the employee's choice, managed by licensed fund managers.

conclusion

Financial Markets are an important component of a country's financial system. It is the infrastructure that connects lender and borrowers. In simple terms, individuals who have surplus money invest in securities and entities which requires capital issues securities. The investors earn a return on the security while the entity gets capital for growing or expanding its business. They perform the important functions of an efficient payment mechanism, providing information about companies, enhancing liquidity of financial claims, transmutation of financial claims to suit the preferences of both savers and borrowers, diversification and reduction of risk, and an efficient source for capital generation and investment. Financial Markets consist of two distinct types of markets – Money Market and Capital Market.

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