The Role of Financial Intermediaries and Capital Market in India

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Abstract

Economic growth of any nation depends mainly on the mobilization of finance. The financial intermediaries and capital market plays an important role in promoting through the flow of long-term savings. The savings get invested in the economy for productive purposes. The capital market in India is a well-integrated structure and its components include stock exchanges, developed banks investment trusts, insurance corporations and provident fund organization. The study mainly focuses on role of financial intermediaries and capital market in India and their contribution to economic development in India.

The beginning part discusses the financial status of India, objectives of the research, Research Methodology. The next section focuses on the review of Literature. In the third section, Financial Intermediaries and capital market; the next section deals with the roles played by financial intermediaries and last section is conclusion.

KEYWORDS: Financial Market, Financial Intermediaries, Capital Market, Economic Growth.

Introduction

The financial system of a country is of immense importance as it portrays the stability as well as sustainability of the country. The financial system consists of a set of complex and closely interconnected financial institutions, markets, instruments, services, practices, and transactions. (Gurusamy, 2008). The role of the financial system is to gather or pool money from people and businesses that have more than they need currently and transmit those funds to those who can use them for either consumption or investment. The larger the flow of funds and the more efficient their allocation is, the better the economic output and welfare of the economy and society.

Objectives of the Research

1. To study about the financial intermediaries and capital market.
2. To study the role of financial intermediaries in economic development in India.

Research Methodology

This paper is mainly based on the reviews of secondary data published in various forms like internet, articles from newspapers and reports published in different forms.

Review of Literature

1. Yogita Wagh and M Mallika Reddy (2016) the study of financial markets explained how price discovery, liquidity and lowering transaction cost function are achieved by financial markets with the help of financial intermediaries. Financial intermediary helps financial markets to mobilize funds from set of investors to borrowers.

2. Nii Ardey Tagoe (2016) the Ghanaian financial intermediation has significantly evolved over the last decades. Banks and other financial intermediaries have moved from the traditional functions to more sophisticated financial intermediation in the financial

market. According to the World Bank, a strong financial system provides reliable and accessible information with lower transaction cost which boost resource allocation and economic growth.

3. Ekta M. Chotaliya (2014) By reviewing the role that intermediary plays in the financial market, it has been very clear and easy to understand that intermediary performs functions that are vital for smooth, organized functioning and growth of the economy. SEBI has different laws and regulations for different intermediaries. The number of registered stock brokers has increased in 2012-13 compared to 2011-12. As the number of Authorized Persons increased, the number of registered sub brokers decreased in 2012-13 compared to 2011-12. Though it did not affect the market reach as APs provide the services and market surface to the investors.

4. Hedi, Fredj, Jawadi&Khuong(2010) the efficient debt market are characterized by competitive market structure ,good infrastructure and high level of diversification and low transaction cost. Where the equity market consist of buying and selling of shares where companies are bound to pay dividends indefinitely as stated.

5. Mahdi Salehi (2008) In this research the authors come to the conclusion that although Iranian financial intermediaries play important role in capital market, the condition of Tehran Stock Market is not suitable. Iranian business sector at first should encourage and establish more financial intermediaries. Secondly, opportunities should be provided to establish foreign financial intermediaries for practicing in Iranian business sectors; as they have long experiences and they may also give new ideas to Iranian business sectors.

6. ThoDinhNguyen(2017), financial intermediaries help reduce informational asymmetries problems through credit screening, delegated monitoring with optimal debt contracts with bankruptcy costs. Policy implications suggest financial liberalization helps remove restrictions and financial repression on financial intermediaries and stimulate economic development.

The financial intermediaries

Financial Intermediaries are the organizations which help in the transfer or channeling of funds from those who have surplus funds to those who are in need of it. They act as a middleman in connecting the surplus parties to the deficit ones. Economies that a bridges the gap between available resources and savings, its helps to increase the wealth and progress. An innovative, competitive and thriving financial intermediaries industry in any country plays a vital role in its smooth functioning and development.

Intermediaries occupy a very imperative space in Indian financial markets. They facilitate proper mobilization of savings into investment. The financial intermediaries primarily they match demand and supply in economy and aim to utilize the resources in a best possible manner. Successful economies generate the opportunities, progress and wealth. So intermediaries play an important central role on the state of economy. In these days of increased complexity of the financial system, banks and other financial intermediaries have to come up with new and innovative products and services to cater to the diverse needs of the borrowers and lenders. It is the right mix of financial products along with the need for reducing systemic risk that determines the efficacy of a financial intermediary.

Financial intermediaries can be:

- Banks;
- Building Societies;
- Credit Unions;
- Financial adviser or broker;
- Insurance Companies;
- Life Insurance Companies;
- Mutual Funds; or
- Pension Funds.

Capital Market:

Financial market deals about the raising of finance by various institutions through the issue of various securities. Every business concern requires two types of finance. They are Short-term or working capital requirements and long-term or fixed capital requirements. The short-term or working capital requirements are raised or borrowed in the money market through the issue of different securities such as bills, promissory notes, etc.

Government raises the short-term funds through the issue of treasury bills. Banks play a vital role in providing short-term funds. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market.

The Role in Economic Development

The functioning of an economy depends on the financial system of a country. The financial system includes banks as a central entity along with other financial services providers. The financial system of a country is deeply entrenched in the society and provides employment to a large population. Financial Intermediaries role in Economic Development

Self-employment programme: Employment growth is a sign of economic development. Financial Intermediaries, by providing finance for starting self-employment programmes are generating more production and income in the country. In India, after the nationalization of commercial banks, a number of programmes have been initiated by banks for self-employment schemes.

Entrepreneurial Development Programmes (EDPs): have been successfully launched by various banks. Initially through Lead Bank Scheme, banks were developing employment opportunities at the district level. Later on, Service Area Approach was adopted in 1978 by which certain specific areas were allotted to the banks for launching different economic programmes for the development of such areas.

Integrated Rural development scheme: Under this scheme, financial intermediaries were financing socially and economically depressed people by providing loans to them

for various economic activities. One third of the loan will be a subsidy and the remaining two-thirds of the loan will carry a lower rate of interest under the interest subsidy scheme of RBI. In this way, various economic programmes aimed at improving rural economic conditions were undertaken.

Housing Finance: As a part of improving dwelling houses, financial intermediaries are providing housing loans. They are also providing refinancing facility to agencies such as HUDCO (Housing and Urban Development Corporation). This has enabled many fixed income group people to avail the housing loan. Normally, to a borrower under this facility, a bank provides 3-year aggregate net income as a maximum amount or the cost of the house, whichever is less.

Priority Sector: As per RBI guidelines, commercial banks have to provide certain percentage of their lending to priority sector which consists of agriculture and its allied activities, such as poultry, dairy, etc, cottage industries, small scale industries, small industry and business.

Backward area Development: In order to prevent regional disparities, financial intermediaries have been advancing loans to industries which are started in backward areas. Government has given certain concessions in the form of tax benefits to such industries and banks provide cheap loans so that the backward areas could attract more industries.

Introduction of Electronic system: Computer is being used by financial intermediaries for most of their activities now and they are able to link their branches through a network. This has resulted in quicker transfer of funds between centres and this has helped customers in realizing their cheques in a speedy manner. It is for this purpose, that Magnetic Ink Character Recognition (MICR) cheques have been introduced. The customer can also make use of Home banking facility by linking their computer system with the bank and instructions can be provided for transfer of funds. This facility, if developed throughout the country, will not only help in the movement of funds but also reduce the disparity in the interest rate.

Demonetization: The demonetisation can well trigger a recession, while not entirely addressing the black economy. This will also affect Reduce the corruption, and Stop terror funding. This demonetisation is not likely to impact the structure, level and incidence of corruption in India. A well-planned demonetisation system can prove beneficial for any economy. However, in case of mishandled support, this may also cause problems. Hence, a public support must be sought for the overall success of this policy. Post demonetization in November 16, the Indian government is monitoring the release of the new currencies and make sure that only the legal currencies are in circulation.

Conclusion

Results revealed that financial development causes economic growth in the long-run in India, using the financial measures of money supply, bank deposits and private domestic credit. This evidence of a long-run causal relationship was supported by investment, which was taken as a proxy for measuring indirect economic growth. Since financial intermediary indicators represent dynamic causality with economic growth,

policy makers should actively develop policies to maintain sustainability of economic growth.

Government of India, consistent with its policy of playing an active role in the industrial development of the country took appropriate steps towards creating a network of financial institutions in the country to fill the gaps in the supply of long term finance to industry. Policies should aim to enhance financial development through the consolidation of the financial-real sector long-run relationship, augmenting credit market competition, relaxing the legal environment to promote new investors and entrepreneurs, and ensuring a tough legal environment to discourage corruption. These measures will develop a better saver-investor relationship to improve the productivity of India.

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