A **bank** is a financial institution that accepts deposits from individuals and lends money to them, as well as to businesses. Banks play a vital role in a country's economic development by mobilizing savings and channelling them into productive investments.

Main functions of a bank:

- Accept deposits (Savings, Current, fixed)
- Provide loans (Home loan, Personal loan, Business loan)
- Issue debit and credit cards
- Facilitate digital payments and money transfers
- Offer investment and insurance services

Banking System in India

The Indian banking system is well-structured and regulated by the **Reserve Bank of India (RBI)**. It is mainly divided into:

(i) Reserve Bank of India (RBI) – ***Central Bank***

- Established in 1935
- Controls money supply and currency issuance
- Regulates banks
- Manages foreign exchange and inflation
- Acts as banker to the government

(ii) Commercial Banks

- Operate in urban and rural areas
- Provide banking services to individuals and businesses
- Include Public Sector Banks (like SBI, PNB), Private Sector Banks (HDFC, ICICI), and Foreign Banks

(iii) Cooperative Banks

- Work on a cooperative basis
- Support small borrowers, farmers, and rural sectors

(iv) Regional Rural Banks (RRBs)

- Established in 1975
- Serves rural areas and small farmers

(v) Development Banks

- Provide long-term loans for industry, agriculture, and infrastructure
- Examples: NABARD (for agriculture), SIDBI (for small industries)

2. Financial System

The **financial system** is the network of institutions, markets, instruments, and services that facilitate the flow of money in an economy.

Financial market may be defined as a transmission mechanism between investors (or lenders) and the borrowers (or users) through which transfer of funds is facilitated. It consists of individual investors, financial institutions and other intermediaries who are linked by formal trading rules and communication network for trading the various financial assets and credit instruments.

Components of the Indian Financial System:

1. **Financial Institutions:**
    - RBI, banks, insurance companies, mutual funds
2. **Financial Markets:**
    - **Money Market:** short-term borrowing/lending (like treasury bills)
    - **Capital Market:** long-term investments (like stocks, bonds)
3. **Financial Instruments:**
    - Currency, shares, bonds, debentures, derivatives
4. **Financial Services:**
    - Banking, insurance, investment management, financial advisory

Need for Financial Market:

- Business units require **short-term and long-term funds**
- Individual savers and institutional investors need **safe investment channels**
- Ensures efficient and systematic **mobilization of savings**

Core Functions:

1. **Mobilization of savings**
2. **Capital formation**
3. **Efficient allocation of resources**
4. **Facilitating liquidity**
5. **Price discovery of financial instruments**

Structure of Financial Market

The financial market in India is broadly classified into:

A. Money Market – For short-term funds (maturity ≤ 1 year)

B. Capital Market – For medium and long-term funds

MONEY MARKET

The money market is a market for short-term funds, which deals in financial Assets/instruments whose period of maturity is less than or up to one year. It should be noted that the money market does not deal in cash or money as such but simply provides a market for short-term credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc.

Characteristics:

- No physical marketplace – transactions take place electronically or via phone
- High liquidity and low risk
- Regulated by **RBI**
- Supports monetary policy implementation

MONEY MARKET INSTRUMENTS

(a) Call Money

- **Meaning**: Short-term borrowing among banks to meet daily cash requirements.
- **Maturity**: From **1 day to 14 days (a fortnight)**.
- **Key Feature**: **Repayable on demand**.
- **Interest Rate**: Known as **call rate**.
- **Use**: Primarily by **banks** to maintain liquidity and meet CRR (Cash Reserve Ratio) obligations.

� **(b) Treasury Bills (T-Bills)**

- **Meaning**: Short-term government securities issued by the **Reserve Bank of India (RBI)**.
- **First Introduced**: In **October 1917**.
- **Maturity**: Maximum up to **364 days** (commonly 91, 182, or 364 days).
- **Issued at Discount**: Sold below face value and redeemed at full value.
  Example: Buy at ₹9,200 → Redeemed at ₹10,000 → Interest = ₹800 → Yield = 8.69%
- **Key Features**:
  - **Highly liquid**

- **Secure investment**
- Involves **no risk of default**

- **Major Investors**: Banks, financial institutions, corporations.

◈ **(c) Commercial Paper (CP)**

- **Meaning**: Unsecured, short-term **promissory note** issued by reputable companies.
- **Introduced in India**: **1990**
- **Maturity**: Ranges from **15 days to 1 year**.
- **Transferable**: Through **endorsement and delivery**.
- **Use**: To meet **working capital needs** of businesses.
- **Eligibility**: Only **financially strong (blue-chip) companies** can issue CP.

◈ **(d) Certificate of Deposit (CD)**

- **Meaning**: Short-term **negotiable time deposit** instrument.
- **Issuer**: Commercial banks and **Special Financial Institutions (SFIs)**.
- **Maturity**: **91 days to 1 year**.
- **Features**:
  - Freely **transferable**
  - Can be issued to **individuals, companies, and cooperatives**
  - Offers **higher interest** than regular savings or fixed deposits

◈ **(e) Trade Bill (Commercial Bill)**

- **Meaning**: A **bill of exchange** used in trade transactions between buyer and seller.
- **Process**:
  - Goods are sold on credit
  - Seller draws a bill on buyer
  - Buyer accepts the bill (becomes negotiable)
  - Seller can **discount the bill with a bank** for immediate funds
  - The bank collects money from the buyer on **maturity**
- **Also Known As**: **Commercial Bill** (when accepted by a bank)
- **Maturity**: Usually within **1 year**
- **Use**: To finance **short-term trade credit**

CAPITAL MARKET

The capital market deals with **medium and long-term investments**, facilitating fundraising through instruments like equity, bonds, and debentures**.** It is an institutional arrangement for borrowing medium and long-term funds and provides facilities for marketing and trading of securities. So, it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue of various securities such as shares, debentures, bonds, etc.

STRUCTURE OF CAPITAL MARKET

The capital market is divided into two main segments:

◆ **1. Primary Market (New Issue Market)**

➤ **Definition:**

The **Primary Market** is where **new securities** are issued and sold for the **first time** by companies or governments to raise capital.

➤ **Objectives:**

- Raise fresh capital for business operations
- Meet expansion and capital expenditure needs
- Launch new projects or repay debts

➤ **Methods of Issue:**

1. **Initial Public Offering (IPO)**
    - First-time public offering of shares
    - Example: LIC IPO in 2022
2. **Follow-on Public Offering (FPO)**
    - Additional issue of shares by a listed company
    - Example: NTPC or ONGC follow-on offers
3. **Private Placement**
    - Offering securities to a small group of investors (banks, mutual funds)
    - Faster and less regulated than IPOs
4. **Rights Issue**
    - Offered to existing shareholders at a discounted price
    - Ensures proportional ownership
5. **Preferential Issue**

    - Allotment of securities to select individuals or institutions at a pre-determined price

➤ **Features:**

- Direct **transfer of funds from investor to issuer**
- No secondary trading
- Involves several **intermediaries**: merchant bankers, underwriters, registrars
- Requires compliance with **SEBI regulations**

2. Secondary Market (Stock Exchange)

A **Stock Exchange** is an organized and regulated marketplace where **existing securities** such as shares, debentures, bonds, and government securities are bought and sold. It functions as a part of the **secondary market** and plays a vital role in the economy by enabling trading of securities in a **transparent, safe, and efficient** manner.

Defined by the **Securities Contracts (Regulation) Act**, a stock exchange is an "association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating, and controlling the business of buying, selling, and dealing in securities."

Key Characteristics of a Stock Exchange

1. **Organized Market**: Operates under structured rules and regulations.
2. **Trading of Existing Securities**: Only already issued and listed securities are traded.
3. **Membership-Based**: Only members (brokers) can trade directly; investors must trade through them.
4. **Rule-Based Transactions**: All dealings follow set procedures and timing, ensuring fairness.
5. **Public Information Access**: Prices and transaction volumes are regularly published for public reference.

Functions of a Stock Exchange

1. Provides a Ready Market for Securities

- Offers a **continuous and liquid platform** for trading.
- Investors can **buy or sell** their securities at will.
- Increases **confidence** in investment due to assured liquidity.

2. Provides Information on Prices and Sales

- Records and **publishes data** on daily trading activities.
- Investors use this information to **make informed decisions**.
- Real-time data also aids in **valuation of holdings and loans**.

3. Ensures Safety and Fairness in Transactions

- Deals occur among **registered members only**.
- Activities are regulated by the **stock exchange and SEBI**.
- Ensures **transparency**, **fair pricing**, and **timely settlement**.

4. Facilitates Mobilization of Savings

- Encourages **investment of surplus funds** into productive channels.
- Helps in **capital formation** and supports industrial growth.
- Educates investors, promoting the habit of saving and investing.

5. Acts as a Barometer of Economic Conditions

- Share prices react to **economic, political, and social changes**.
- High trading volumes and price rise indicate **economic prosperity**.
- Downturns reflect **economic stagnation or investor pessimism**.

6. Efficient Allocation of Resources

- Capital flows to the most **profitable and promising enterprises**.
- Ensures **optimal use of financial resources** in the economy

Advantages of Stock Exchanges

A. To Companies

1. Improved **reputation and creditworthiness**
2. Access to a **wider investor base**
3. Increased **valuation** of securities
4. Greater control over **issue size, pricing, and timing**

B. To Investors

1. **Liquidity** – buy/sell anytime
2. **Safety** – regulated trading environment
3. **Price transparency** – real-time updates
4. Easier to get **bank loans** using securities as collateral

C. To Society

1. Promotes **savings and capital formation**
2. Boosts **industrial growth** via investment
3. Ensures **flow of funds to productive sectors**

4. Reflects **economic health**
5. Facilitates **government borrowing** via bonds

Limitations of Stock Exchanges

1. Excessive Speculation

- Trading purely for profit based on short-term price changes.
- Can lead to **price volatility** and **market instability**.
- Genuine long-term investors may suffer losses.

2. Price Fluctuations

- Securities may be influenced by:
  - **Political events**
  - **Economic news**
  - **Social changes**
  - **False rumors**

SEBI (Securities and Exchange Board of India)

Introduction

- The Securities and Exchange Board of India (SEBI) is the regulatory authority for securities markets in India.
- Established in 1988 and given statutory powers in 1992, SEBI plays a crucial role in maintaining transparency, efficiency, and investor protection in the Indian capital market.
- This lecture will cover SEBI's objectives, functions, powers, key regulations, and its impact on the Indian financial market.

Need for SEBI

Challenges Before SEBI's Formation

- Lack of a strong regulatory body for stock markets.
- Rampant insider trading, market manipulation, and fraudulent practices.
- Stock market scams like the Harshad Mehta scam (1992) exposed the need for stricter regulations.
- Low investor confidence due to unfair trading practices.

Objectives of SEBI

- Protect investors' interests.
- Regulate the securities market and prevent fraudulent practices.

- Develop and promote an efficient and transparent capital market.
- Ensure fair and transparent functioning of stock exchanges.

Structure of SEBI

- Headquarters: Mumbai, India.
- Chairperson: Appointed by the Government of India.
- Board Members: Consist of representatives from the Government of India, RBI, and the Ministry of Finance.

Functions of SEBI

SEBI performs three primary functions:

A. Regulatory Functions

- Regulates stock exchanges and market intermediaries.
- Enforces disclosure norms for listed companies.
- Prevents market manipulation and insider trading.
- Oversees mutual funds, foreign institutional investors (FIIs), and credit rating agencies.

B. Developmental Functions

- Promotes investor education and awareness.
- Encourages new financial instruments and trading mechanisms.
- Supports capital market digitalization and automation.

C. Protective Functions

- Prohibits unfair trade practices and fraudulent schemes.
- Implements investor protection measures such as grievance redressal mechanisms.
- Ensures corporate governance and transparency in financial reporting.

Powers of SEBI

Legislative Powers

- Can frame rules and regulations for securities markets.
- Implements the SEBI Act, 1992, and other financial laws.

Executive Powers

- Can inspect and investigate stock exchanges and financial institutions.
- Can issue guidelines and orders for compliance.

Quasi-Judicial Powers

- Has the authority to penalize violators and impose fines.
- Can ban companies, brokers, or individuals for illegal activities.

Key Regulations by SEBI

A. Insider Trading Regulations

- Restricts company insiders from trading on confidential information.
- Companies must disclose material events to the public fairly.

B. Listing and Disclosure Requirements

- Mandates timely financial disclosures and governance reports by listed companies.

C. Mutual Fund Regulations

- Ensures mutual funds operate transparently and fairly for investors.

D. Foreign Portfolio Investment (FPI) Regulations

- Regulates foreign investments to maintain market stability.

E. Takeover Code

- Governs how companies can acquire stakes in other firms.

F. Securities and Exchange Regulations

- Sets rules for Initial Public Offerings (IPOs) and stock market trading.8. Challenges Faced by SEBI
- Cybersecurity risks in stock market transactions.
- Need for faster enforcement of penalties.
- Balancing foreign investment regulations without harming market growth.
- Controlling stock market volatility and algorithmic trading risks

Capital Market Reforms and Development

Introduction

- The capital market plays a crucial role in economic growth by facilitating long-term funding for businesses and governments.
- Over time, capital markets have evolved through various reforms to enhance efficiency, transparency, and investor confidence.
- This lecture will cover the significance of capital market reforms, key developments, and their impact on economic growth.

1. Understanding Capital Markets

Definition and Importance

- A capital market is a financial system where long-term securities (stocks, bonds, etc.) are traded.
- It connects investors (individuals, institutions) with entities in need of capital (corporations, governments).
- Well-functioning capital markets contribute to economic development by improving resource allocation and liquidity.

Components of Capital Markets

1. **Primary Market** – Where new securities are issued (Initial Public Offerings - IPOs).
2. **Secondary Market** – Where existing securities are traded among investors (Stock Exchanges).
3. **Debt Market** – Bonds and other debt instruments for long-term borrowing.
4. **Equity Market** – Shares and stocks representing ownership in a company.

2. Need for Capital Market Reforms

Challenges in Capital Markets

- **Lack of transparency and weak regulatory framework**
- **Insider trading and market manipulation**
- **Low retail investor participation**
- **Limited access to capital for small and medium enterprises (SMEs)**
- **Underdeveloped debt and bond markets**

Objectives of Reforms

- Improve efficiency, transparency, and investor protection.
- Strengthen regulatory institutions.
- Increase participation of retail and institutional investors.
- Enhance liquidity and access to financing.

Key Capital Market Reforms

A. Regulatory Strengthening

- Establishment of strong regulatory bodies like **SEBI (India), SEC (U.S.), FCA (UK)**.
- Introduction of stricter **corporate governance and disclosure norms**.
- Stricter penalties for **market manipulation and insider trading**.

B. Digitalization and Technology Adoption

- Introduction of **online trading platforms and dematerialization of securities**.
- Use of **AI and blockchain** to prevent fraud and improve transparency.

C. Market Structure and Infrastructure Development

- Introduction of **T+1 settlement cycle** to enhance liquidity.
- Strengthening of **depository and clearing corporations**.
- Expansion of derivative markets for risk management.

D. Foreign Investment Liberalization

- **Relaxation of FDI norms** in stock markets.
- Allowing **foreign portfolio investors (FPIs)** to invest in equity and debt markets.

E. Development of Bond and Debt Markets

- Encouraging corporate bonds for **long-term financing options**.
- Development of **municipal and green bonds** for sustainable financing.

F. Enhancing Retail Investor Participation

- Promotion of **mutual funds, ETFs, and systematic investment plans (SIPs)**.
- Introduction of **investor awareness and education programs**.

Impact of Capital Market Reforms on Economic Growth

- **Increased capital formation** for businesses and governments.
- **Enhanced investor confidence**, leading to higher market participation.
- **Greater financial inclusion**, allowing more individuals and small businesses to access markets.
- **Higher foreign investment inflows**, boosting economic growth.
- **Improved market efficiency and transparency**, reducing risks.

Industrial Financial Institutions in India

Introduction

Industrial Financial Institutions (IFIs) in India provide long-term funding for industries, infrastructure projects, and small businesses. They play a crucial role in **economic growth, employment generation, and technological advancement**.

1. Need for Industrial Financial Institutions

Before IFIs, industries in India faced:

- **Lack of long-term credit** – Commercial banks offered mainly short-term loans.
- **High capital requirements** – Large projects required substantial investment.
- **Limited access for MSMEs** – Small businesses struggled to obtain loans.
- **Technological backwardness** – Industries needed financing for modernization.

- **Slow economic development** – Insufficient funding hampered growth.

Role of IFIs:

- Provide **long-term capital** for industrial expansion.
- Fund **infrastructure projects** like roads, power, and telecom.
- Support **MSMEs and startups**.
- Encourage **entrepreneurship and technology upgradation**.
- Boost **exports** by financing international trade.

Types of Industrial Financial Institutions in India

1. **All-India Development Financial Institutions (DFIs)** – These cater to large industries across India.
2. **State-Level Financial Institutions (SFCs & SIDCs)** – These support industrial growth at the state level.
3. **Specialized Financial Institutions** – These provide funding for specific industries, such as exports, housing, and rural development.

1. Industrial Development Bank of India (IDBI)

✅ **Established**: 1964
✅ **Regulated by**: Reserve Bank of India (RBI)
✅ **Headquarters**: Mumbai
✅ **Ownership**: Originally government-owned but later converted into a commercial bank.

Objectives of IDBI

- Promote **industrial growth and modernization**.
- Provide **long-term loans** to medium and large-scale industries.
- Assist in **entrepreneurial development**.
- Support infrastructure projects like **power plants, highways, and industrial zones**.

Functions of IDBI

🔶 **Direct Financing** – Offers loans for large industrial projects.
🔶 **Refinancing** – Provides financial assistance to commercial banks and NBFCs for industrial lending.
🔶 **Venture Capital Assistance** – Funds startups and high-risk industries.
🔶 **Foreign Collaboration** – Facilitates foreign investment in Indian industries.

🔶 **Example**: IDBI has funded projects in **steel, telecom, manufacturing, and power sectors**.

2. Industrial Finance Corporation of India (IFCI)

✅ **Established**: 1948 (First Development Financial Institution in India)
✅ **Regulated by**: Government of India
✅ **Headquarters**: New Delhi
✅ **Purpose**: Providing long-term financial support to industries.

Objectives of IFCI

- Develop **infrastructure and large industries**.
- Provide financial assistance to **industrial projects, including new and existing units**.
- Promote **regional industrial growth**.

Functions of IFCI

💠 **Term Loans** – Provides loans for setting up new industries and expanding existing ones.
💠 **Underwriting Services** – Helps companies raise funds by issuing shares and bonds.
💠 **Infrastructure Financing** – Funds projects like **roads, bridges, airports, and power plants**.
💠 **Restructuring of Sick Units** – Supports industries facing financial difficulties.

💠 **Example**: IFCI has financed projects in **textiles, engineering, and IT**.

3. Small Industries Development Bank of India (SIDBI)

✅ **Established**: 1990
✅ **Regulated by**: Ministry of Finance, Government of India
✅ **Headquarters**: Lucknow
✅ **Purpose**: Supporting **Micro, Small, and Medium Enterprises (MSMEs)**.

Objectives of SIDBI

- Promote **small and medium enterprises (SMEs)**.
- Provide credit to **startups and entrepreneurs**.
- Facilitate **modernization and expansion** of MSMEs.

Functions of SIDBI

💠 **Direct Financing** – Provides loans to small businesses.
💠 **Refinancing Support** – Helps banks and NBFCs provide credit to MSMEs.
💠 **Technology Development** – Supports MSMEs in adopting new technology.
💠 **Export Promotion** – Encourages MSMEs to compete in global markets.

💠 **Example**: SIDBI has supported **handicrafts, food processing, and IT startups**.

4. Industrial Investment Bank of India (IIBI)

✅ **Established**: 1997 (Converted from Industrial Reconstruction Bank of India)
✅ **Regulated by**: Government of India

✅ **Headquarters**: Kolkata
✅ **Purpose**: **Revival and restructuring of financially struggling industries**.

Objectives of IIBI

- Support **industries facing financial distress**.
- Provide financial and technical assistance to **sick industries**.
- Help businesses in **mergers, acquisitions, and corporate restructuring**.

Functions of IIBI

🔷 **Turnaround Financing** – Provides funds for struggling industries.
🔷 **Management & Technical Assistance** – Helps industries improve efficiency.
🔷 **Working Capital Support** – Provides short-term loans for operational expenses.

🔷 **Example**: IIBI has helped **iron, steel, and textile** industries recover from financial crises.

5. National Bank for Agriculture and Rural Development (NABARD)

✅ **Established**: 1982
✅ **Regulated by**: Reserve Bank of India (RBI) and Government of India
✅ **Headquarters**: Mumbai
✅ **Purpose**: Financing **agriculture and rural industries**.

Objectives of NABARD

- Provide credit for **agriculture and rural industries**.
- Develop rural infrastructure, including **roads, storage, and irrigation facilities**.
- Support **self-employment programs**.

Functions of NABARD

🔷 **Loans to Rural Industries** – Supports agro-based businesses and cooperatives.
🔷 **Microfinance Support** – Works with banks to provide small loans to rural entrepreneurs.
🔷 **Development of Rural Handicrafts** – Funds small-scale rural industries.

🔷 **Example**: NABARD has funded **dairy farming, organic farming, and food processing** projects.

6. State Financial Corporations (SFCs)

✅ **Established**: Under the **State Financial Corporations Act, 1951**
✅ **Regulated by**: Respective State Governments
✅ **Purpose**: Supporting **small and medium enterprises (SMEs)** at the state level.

Functions of SFCs

◈ **Term Loans** – Provides long-term finance to SMEs.
◈ **Working Capital Financing** – Offers short-term loans for operational needs.
◈ **Equipment Leasing** – Helps businesses acquire machinery and technology.

◈ **Example**:

- **Haryana Financial Corporation (HFC)** – Supports local MSMEs.
- **Tamil Nadu Industrial Investment Corporation (TIIC)** – Funds businesses in Tamil Nadu.

Other Specialized Industrial Financial Institutions

7. Export-Import Bank of India (EXIM Bank)

✅ **Established**: 1982
✅ **Purpose**: Supporting **Indian exports**.
◈ Provides credit to exporters.
◈ Helps businesses expand internationally.

8. Housing and Urban Development Corporation (HUDCO)

✅ **Established**: 1970
✅ **Purpose**: Financing **housing and urban infrastructure projects**.
◈ Funds affordable housing and urban development projects.

9. Infrastructure Development Finance Company (IDFC)

✅ **Established**: 1997
✅ **Purpose**: **Financing large infrastructure projects**.
◈ Provides loans for roads, power plants, and airports.