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1. Learning Outcomes

After studying this module, you shall be able to

- Know various classifications of Financial Markets
- Learn about Money Market in India with its salient features
- Know the functions and deficiencies of Indian Money Market
- Study the organized and unorganized sector of Indian Money Market
- Identify the various instruments of Money Market

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2. Introduction

Financial Market

Financial Market is a market for creation and exchange of financial assets. It is the centers or arrangements that provide facilities for buying and selling of financial claims and services. The corporations, financial institutions, individuals and government trade in financial products on these markets either directly or through brokers and dealers on organized exchanges or off-exchanges. The participants on the demand and supply sides of these markets are financial institutions, agents, brokers, dealers, borrowers, lenders, savers and others who are inter linked by the laws, contract and communication networks.

Financial Market can be classified on the following basis.

Table 1: Classification of Financial Markets

Sl. No	Basis of Classification	Types of Market	
1	Nature of Claim	Debt Market	Equity Market
2	Maturity of Claim	Money Market	Capital Market
3	Seasoning of Claim	Primary Market	Secondary Market
4	Timing of Delivery	Cash/Spot Market	Forward/Futures Market
5	Organisational Structure	Exchange Traded Market	Over-the-Counter Market

As shown in table, the market for short term financial claim is referred as Money Market and the market for long term financial claims is called the capital market.

3. Money Market in India: An Overview

The Money market in India is the money market for short-term and long-term funds with maturity ranging from overnight to one year in India including financial instruments that are deemed to be close substitutes of money**.** A money market is a market for borrowing and lending of short-term funds. It deals in funds and financial instruments having a maturity period of one day to one year. It is a mechanism through which short-term funds are loaned or borrowed and through which a large part of financial transactions of a particular country or of the world are cleared. RBI describes money market as “the center for dealings, mainly of a short-term character, in monetary assets, it meets the short-term requirements of borrowers and provides liquidity or cash to lenders".

3.1 Salient features of Money Market

- The Money Market is a instrument that contracts with the loaning and borrowing of short term funds (not more than one year)
- It is a section of the financial marketplace in which financial instruments with high liquidity and very short maturities are operated.
- It does not actually deal in cash or money but deals with substitute of cash like trade bills, promissory notes and government papers which can be converted into cash without any loss at low transaction cost.
- It includes all individual, institution and intermediaries.
- Transactions have to be conducted without the help of brokers.

3.2 Functions of Money Market

1) It caters to the short-term financial requirements of the economy.
2) It supports the RBI in actual enactment of budgetary policy.
3) It offers instrument to attain equilibrium amongst demand and supply of short-term funds.
4) It helps in distribution of short term funds through inter-bank dealings and money market devices.
5) It also provides funds in non-inflationary way to the administration to meet its shortfalls.
6) It simplifies economic enlargement.

3.3 Deficiencies of Money Market

Indian money market is comparatively underdeveloped when associated with progressive markets like New York and London Money Markets. Its' main defects are as follows;

1. Dichotomy:-A main feature of Indian Money Market is the existence of dichotomy i.e. presence of two markets: - organized Money Market and Unorganized Money Market. It is difficult for RBI to integrate the organized and Unorganized Money Markets. Several segments are loosely connected with each other. Thus there is dichotomy in Indian Money Market.
2. Lack of Co-ordination and Integration:-It is challenging for RBI to take part the organized and unorganized sector of money market. RBT is completely effective in organized sector but unorganized market is out of RBI's control. Thus there is lack of integration between various sub-markets as well as numerous institutions and activities. There is less co-ordination among co-operative and commercial banks along with State and Foreign banks. The indigenous bankers have their own ways of doing business.
3. Diversity in Interest Rates:-There are different rates of interest existing in different segments of money market. In rural unorganized sectors the rate of interest are high and

they vary with the purpose and borrower. There are differences in the interest rates within the organized sector also. Although wide modifications have been narrowed down, yet the existing differences do hamper the efficiency of money market.

4. Seasonality of Money Market :-Indian agriculture is busy during the period November to June resulting in heavy demand for funds. During this period money market suffers from Monetary Shortage resulting in high rate of interest. During slack season rate of interest falls so there are plenty of funds available. RBI has taken steps to reduce the seasonal fluctuations, but still the variations exist.
5. Shortage of Funds: - In Indian Money Market demand for funds go beyond the supply. There is lack of funds in Indian Money Market an account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy etc. There is also vast amount of black money in the country which have caused shortage of funds. However, in recent years development of banking has improved the mobilization of funds to some extent.
6. Absence of Organized Bill Market: - A bill market refers to a mechanism where bills of exchange are purchased and discounted by banks in India. A bill market provides short term funds to businessmen. The bill market in India is not widely held due to overdependence of cash dealings, high disregarding rates, problem of dishonor of bills etc.

4. Organization of Indian Money Market

Indian money market is considered by its dichotomy i.e. there are two sectors of money market. The organized sector and unorganized sector.

❖ **Organized Sector**

- Reserve Bank of India
- Discount and Finance House of India (DFHI)
- Public Sector Banks
  - SBI and its seven Subsidiaries and 20 Nationalized Banks
  - Regional Rural Banks
- Private Sector Banks
  - Foreign Banks
  - Scheduled Commercial Banks
  - Non-Scheduled Commercial Banks
- Co-operative Sector Banks
- Development Banks
- Insurance Companies

i. Unorganised Sector

- Moneylenders
- Indigenous bankers, and
- unregulated Non-Bank Financial Intermediaries
  - Loan & Finance companies

- Chit funds
- Nidhis
- Finance Brokers

4.1 Organised Sector

***4.1.1 Reserve Bank of India* (RBI)**

The Reserve Bank of India (RBI) is India's central banking institution, which controls the monetary policy of the Indian rupee. It was established on 1 April 1935 during the British rule in accordance with the provisions of the Reserve Bank of India Act, 1934. The bank was set up based on the recommendations of the 1926 Royal Commission on Indian Currency and Finance, also known as the Hilton–Young Commission.

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations.(except one rupee note and coin, which are issued by Ministry of finance). The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the government. For printing of notes, the Security Printing and Minting Corporation of India Limited (SPMCIL).

The Reserve Bank of India is the main monetary authority of the country and beside that the central bank acts as the bank of the national and state governments. It formulates, implements and monitors the monetary policy as well as it has to ensure an adequate flow of credit to productive sectors.

RBI also works as a central bank where commercial banks are account holders and can deposit money. RBI maintains banking accounts of all scheduled banks.[33] Commercial banks create credit. It is the duty of the RBI to control the credit through the CRR, bank rate and open market operations. As banker's bank, the RBI facilitates the clearing of cheques between the commercial banks and helps inter-bank transfer of funds.

4.1.2 Discount and Finance House of India (DFHI)

Discount And Finance House of India Ltd (DFHI) DFHI was set up in March 1988 by Reserve Bank of India together with public sector banks and all India Financial Institutions to improve the money market and to provide liquidity to money market instruments as a sequel to Vaghul Working Group recommendations. After DFHI was credited as a Primary Dealer in February 1996, its operations significantly increased particularly in Treasury Bills and dated Government Securities.

4.1.3 Public Sector Banks

Public Sector Banks (PSBs) are banks where a common stake (i.e. more than 50%) is held by a government. The shares of these banks are listed on stock exchanges. The Central Government come in the banking business with the nationalization of the Imperial Bank of India in 1955. A 60% stake was taken by the Reserve Bank of India and the new bank was named as the State Bank of India. The seven other state banks became the subsidiaries of the new bank when nationalized on 19 July 1960.
The next round of nationalization took place in April 1980. The government nationalized six banks. The total deposits of these banks amounted to around 200 crores. This move led to a further rise in the number of branches in the market, increasing to 91% of the

total branch network of the country. Presently, 20 nationalized banks and SBI with its 7 subsidiaries come under the category of PSBs.

4.1.4 Private Sector Banks

In July 1993, as portion of the banking improvement process and as a extent to convince competition in the banking sector, RBI allowed item by the private sector into the banking system. This resulted in the introduction of nine private sector banks. The Government of India permits foreign banks to operate through branches; a wholly owned subsidiary; or a secondary with collective foreign investment of up to 74% in a private bank. Banks have to maintain certain percentage of deposit with Reserve bank of India (RBI) as CRR (Cash Reserve Ratio) on which they earn lower interest.

4.1.5 Co-operative Sector Banks

Cooperative banks are an important constituent of the Indian financial system. They are the primary financiers of agricultural activities, some small-scale industries and self-employed workers. Co-operative Bank are organized and managed on the principal of co-operation, self-help, and mutual help. Co-operative banks, as a principle, do not pursue the goal of profit maximization

Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products. However, co-operative banks now provide housing loans also

4.1.6 Development Banks

A Development Bank is an all purpose institution giving a new shape to economic development pattern and accelerating the activities of all branches of economy and creating healthy financial and socio-economic infrastructure. They act as 'gap filler' in the present set up of the entrepreneurial world. They are energetically and enthusiastically engaged in the herculean task of planning, promoting and developing industries in every sector of the national economy. They are operating as promotional, innovative and entrepreneurial Development Banks in all over the world.

The objectives to be achieved by Development Banks may be enumerated as speeding up economic growth, rapid industrialization, rural development, support to industry, entrepreneurial development, project finance, refinance, development of backward areas, housing. In addition, they are assigned a special role in (1) Planning, promoting and developing industries to fill the gaps in the industrial structure (ii) Co-ordinating the working of institutions engaged in financing, promoting or developing industries, agriculture and trade (iii) Providing technical and administrative assistance and (iv) Undertaking marketing and investment research and surveys.

IFCI LTD, ICICI, IDBI, IIBI, SIDBI and IDFC are the examples of Development Banks in India,

4.1.7 Insurance Companies

The Government of India distributed an Ordinance on 19 January 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into presence in the same year. The Life Insurance Corporation (LIC) captivated 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all.

The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India GIC). GIC had four subsidiary companies. With effect from

4.2 Unorganised Sector

4.2.1 Indigenous Bankers (IBs)

Indigenous bankers are individuals firms who receive deposits and give loans and thereby operate as banks. IBs accept deposits as well as lend money. They mostly operate in urban areas, especially in western and southern regions of the country. The volume of their credit operations is however not known. Further their lending operations are completely unsupervised and unregulated. Over the years, the significance of IBs has declined due to growing organized banking sector.

4.2.2 Money Lenders (MLs)

They are those whose primary business is money lending. Money lending in India is very popular both in urban and rural areas. The operations of money lenders are prompt, informal and flexible. The borrowers are mostly poor farmers, artisans, petty traders and manual workers. Over the years the role of money lenders has declined due to the growing importance of organized banking sector.

4.2.3 Unregulated Non - Banking Financial Companies (NBFCs)

They mainly consist of the following;

- **Chit Funds:** Chit funds are savings institutions. It has regular members who make periodic subscriptions to the fund. The beneficiary may be selected by drawing of lots. Chit fund is more popular in Kerala and Tamil Nadu. RBI has no control over the lending activities of chit funds.
- **Nidhis:** Nidhis function as a kind of mutual benefit for their participants only. The loans are given to memberships at a reasonable rate of interest. Nidhis function mainly in South India.
- **Loan or Finance Companies:** Loan companies are establish in all parts of the country. They give loans to retailers, wholesalers, artisans and self-employed persons. They offer a high rate of interest along with other incentives to attract deposits. They charge high rate of interest varying from 36% to 48% p.a.
- **Finance Brokers:** They are found in all major urban markets especially in cloth, grain and commodity markets. They act as middlemen between lenders and borrowers. They charge commission for their services.

5. Instruments of Money Market

The various traditional and new instruments for dealing in Money Market are;

1. Call/Notice/Term Money
2. Treasury Bill (T-Bills)
3. Commercial Bill

4. Repurchase Agreement (Repo & Reverse Repo)
5. Commercial Papers (CPs)
6. Certificate of Deposits (CDs)
7. Money Market Mutual Fund (MMMF)

5.1 Call Money

The call money deals in short term finance repayable on demand, with a maturity period varying from one day to 14 days. As loans are payable on demand and at the option of either the lender or the borrower, they are highly liquid, their liquidity being exceeded only by cash.

- Unlike in other countries, Call loans in India are unsecured and subject to seasonal variations. Call money borrowings tend to increase when there is an increase in the CRR.
- Commercial banks both Indian and foreign, co-operative banks, Discount and Finance House of India Ltd.(DFHI), Securities trading corporation of India (STCI) participate as both lenders and borrowers and Life Insurance Corporation of India (LIC), Unit Trust of India(UTI), National Bank for Agriculture and Rural Development (NABARD), Industrial Development Bank (IDBI), General Insurance Corporation (GIC) can participate only as lenders.
- There are now two call rates in India: the Interbank call rate and the lending rate of DFHI.

5.2 Treasury Bill (T-Bills)

Treasury bills is a particular kind of finance bill (not arise from genuine transaction in goods) or a promissory note put out by the government. Treasury bills are device of short-term borrowing by the Government of India, issued as promissory notes under deduction. Bills are highly liquid because there cannot be better guarantee of repayment of loan than the one given by the central government. TBs have assured yield, low transactions cost, negligible capital depreciation and negligible risk of default and most important, they are eligible for inclusion in Statutory Liquidity Ratio (SLR).

- TBs are issued at a discount by the RBI on behalf of the Central Government as its agent.
- Presently, all types of TBs are sold through auctions.
- In case of 91-day TBs, the auction system was introduced from January 1, 1993 while in the case of other types of TBs, it was introduced from their respective dates of launching. In case of 91-day TB, the auctions are weekly and the amount of auction has to be notified whereas in the case of ther types of TBs, the auctions are fortnightly and there is no need to notify the auction amount.
- With the introduction of the auction system, interest rates on all types of TBs are being determined by the market forces.
- **91-Day Treasury Bills**
    - Two types of TBs have been in vague in India. Adhoc and regular.
    - The adhoc bills are allotted for investment by the state governments, semi government sections and foreign central banks for momentary investment. They are not sold to banks and general public. As adhoc bills were issued

in favor of the RBI only, they were purchased by RBI on tap. Ad-hoc bills were abolished in April 1, 997.

 - The treasury bills sold to the public and banks are called regular treasury bills. They are freely marketable.
 - Commercial banks buy entire quantity of such bills issued on tender. They are bought and sold on discount basis.
 - They are issued by tender till 1965 but with effect from July 12, 1965 they were available on tap throughout the week at rates announced from time to time. The auction system was introduced from January 1, 1993

- **182-Day Treasury Bills** was introduced in November 1986 which was normally issued at discount to face value for a minimum of Rs one lakh and its multiples thereof but bills were discontinued from April 1, 1992.
- **364-Day Treasury Bills** was introduced from April 1, 1992. The yield on 364-day TB has been quite attractive and higher than the yield on the other bill.
- **14-Day Treasury Bills** was introduced with a view to diversity the TBs market. On April 1, 1997, the first type of 14-day TB known as Intermediate Treasury Bill (ITB) was introduced which replace 91-day tad bill and sold only to state government, foreign central banks and on May 20, 1997, the second types of 14-day TB was introduced.

5.3 Commercial Bills

Commercial bills are short term, negotiable and self-liquidating money market instruments with low risk. A bill of exchange is drawn by a seller on the buyer to make payment within a certain period of time. Generally, the maturity period is of 30 days-180 days.

- The two main types of bills are demand bill and usance bill.
- A demand bill is payable “at sight” or “on presentment” to the drawee.
- Usance or time bill is payable at a specified later date.
- Bills can also be classified as clean bills, documentary bills, inland bills, foreign bills and supply bills. The indigenous variety of a bill of exchange is called hundi.
- Commercial bill can be resold a number of times during the usance period of bill.
- The rates which reflects the cost of bill finance are bank rate, SBI hundi rate, bazzar bill rate, SBI discount rate and commercial banks’ bill finance rate.
- In India, the commercial bill market is very much underdeveloped.
- RBI has introduced an innovative instrument known as “Derivative Usance Promissory Notes, with a view to eliminate movement of papers and to facilitate multiple rediscounting.
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5.4 Certificate of Deposits (CDs)

The scheme of CDs was introduced in 1989 by RBI. Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialized form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institution for a specified time period.

- CDs can be distributed by scheduled commercial banks (excluding Regional Rural Banks and Local Area Banks), and select All-India Financial Institutions (FIs) that have been allowed by RBI to rise short-term resources within the umbrella limit fixed by RBI.
- Banks have the freedom to issue CDs depending on their funding requirements.
- Minimum amount of a CD should be Rs.1 lakh, i.e., the minimum deposit that could be accepted from a single subscriber should not be less than Rs.1 lakh, and in multiples of Rs. 1 lakh thereafter.
- In 1992, RBI allowed four financial institutions ICICI, IDBI, IFCI and IRBI to issue CDs with a maturity period of. one year to three years.
- CDs may be distributed at a discount on face value.
- The distributing bank / Financial Institutions is free to regulate the discount coupon rate. The interest rate on floating rate CDs would have to be reset periodically in accordance with a pre-determined formula that indicates the spread over a transparent benchmark. The investor should be clearly informed of the same.

5.5 Commercial Papers (CPs)

It was introduced in India in 1990 with a view to enabling much rated corporate mortgagors to expand their sources of short-term borrowings and to offer an extra instrument to investors.

- Commercial Paper (CP) is an unsecured money market tool issued in the form of a promissory note.
- Corporates, primary dealers (PDs) and the All-India Financial Institutions (FIs) are eligible to issue CP. However, A corporate would be eligible to issue CP provided –
    - the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore
    - company has been sanctioned working capital limit by bank/s or all-India financial institution/s; and
    - The borrowable account of the company is classified as a Standard Asset by the financing bank/s/ institution/s.
- CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue.
- CP can be issued in denominations of Rs.5 lakh or multiples thereof.
- The aggregate amount of CP from an issuer shall be within the limit as approved by its Board of Directors or the quantum indicated by the Credit Rating Agency for the specified rating, whichever is lower.
- CP will be issued at a discount to face value as may be determined by the issuer.
- CPs are actively traded in the OTC market. Such transactions, however, are to be reported on the Fixed Income Money Market and Derivatives Association of India (FIMMDA) reporting platform within 15 minutes of the trade for dissemination of trade information to market participation thereby ensuring market transparency.
- Only a scheduled bank can act as an Issuing and paying Agent (IPA) for issuance of CP.

- Initially the investor in CP is required to pay only the discounted value of the CP by means of a crossed account payee cheque to the account of the issuer through IPA. On maturity of CP,
  (a) when the CP is held in physical form, the holder of the CP shall present the instrument for payment to the issuer through the IPA.
  (b) when the CP is held in demat form, the holder of the CP will have to get it redeemed through the depository and receive payment from the IPA.

5.6 Repurchase Agreement (Repo & Reverse Repo)

Repurchase Market which is also known as Repo or RP or Ready Forward Agreement is a transaction in which one party (seller/lender of security or borrower of cash) sells a security to another party (buyer/borrower of security or lender of cash) simultaneously agreeing to repurchase it in future at specified date and time. Reverse Repo is exactly opposite of RP in which a party buys a security from another party with a commitment to sell it back to the latter at specified time and price. In the other words, for one party who is seller of security, the transaction is Repo while for the other party who is buyer of security, it is Reverse Repo.

- It was introduced in December 1992.
- Repo transactions are affected between banks and financial institutions and among bank themselves, RBI also undertake Repo.
- In November 1996, RBI introduced Reverse Repo. It means buying a security on a spot basis with a commitment to resell on a forward basis. Reverse Repo transactions are affected with scheduled commercial banks and primary dealers.
- In March 2003, to broaden the Repo market, RBI allowed NBFCs, Mutual Funds, Housing Finance and Companies and Insurance Companies to undertake REPO transactions.

5.7 Money Market Mutual Funds (MMMFs)

Money Market Mutual Funds (MMMFs) are a part of short-term investment pooling arrangement. Their basic function is to purchase large pools of short-term financial instruments and sell shares in these pools of investment. As most of the money market instruments have to be purchased in large amounts and the pooling arrangements enable small investors to gain access to money market yields.

Money market funds allow retail investors the opportunity of investing in money market instrument and benefit from the price advantage.

- Money Market Mutual Funds (MMMFs) were introduced in India in April 1991 to provide an additional short term investment avenue to investors and to bring money market instruments within the reach of individuals.
- The guidelines for MMMFs were announced by the Reserve Bank in April 1992. The Reserve Bank had made several modifications in the scheme to make it more flexible and attractive to banks and financial institutions.
- In November 1995 RBI made the scheme more flexible. The existing guidelines allow banks, public financial institutions and also private sector institutions to set up MMMFs.

- MMMFs are allowed to issue units to corporate enterprises and others on par with other mutual funds.
- Resources mobilised by MMMFs are now required to be invested in call money, CD, CPs, Commercial Bills arising out of genuine trade transactions, treasury bills and government dated securities having an unexpired maturity upto one year.
- Since March 7, 2000 MMMFs have been brought under the purview of SEBI regulations.

5. Summary

- Financial Market is a market for creation and exchange of financial assets.
- On the basis of maturity of claim, financial market can be classified as money market and capital market.
- The market for short term financial claim is referred as Money Market and the market for long term financial claims is called the capital market.
- The Money market in India is the money market for short-term and long-term funds with maturity ranging from overnight to one year in India including financial instruments that are deemed to be close substitutes of money.
- Instruments for dealing in Money Market are Call Money, Treasury Bill (T-Bills), Commercial Bill, Repurchase Agreement (Repo & Reverse Repo), Commercial Papers (CPs), Certificate of Deposits (CDs) and Money Market Mutual Fund (MMMF)
- Treasury bills are instrument of short-term borrowing by the Government of India, issued as promissory notes under discount. Currently 91-day TB and 364-day TB are in Indian market.
- Commercial bills are short term, negotiable and self liquidating money market instruments with low risk.
- The two main types of bills are demand bill and usance bill. A demand bill is payable "at sight" or "on presentment" to the drawee. Usance or time bill is payable at a specified later date.
- Bills can also be classified as clean bills, documentary bills, inland bills, foreign bills and supply bills.
- Reverse Repo is exactly opposite of RP in which a party buys a security from another party with a commitment to sell it back to the latter at specified time and price.
- Money Market Mutual Funds (MMMFs) are a part of short-term investment pooling arrangement. Their basic function is to purchase large pools of short-term financial instruments and sell shares in these pools of investment.