
Chapter-Financial system

Monetary Economics and Financial System

B.com-Sem -4

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- The primary function of the financial system is to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth.

-Robinson

- The purpose of financial system is to distribute the supply of money various economic sections and various sectors in such a way that these financial means can be used effectively without an unnecessary interference and without affecting the price level.

-Christy

Introduction

- After independence many changes took place in Indian economy. As a result, there has remarkable progress in many economic fields. Economic activities expanded and also became diversified. After the experience of the 1980's, it was realized that to attain assured benefits of free market economy, efficient financial is inevitable in india.

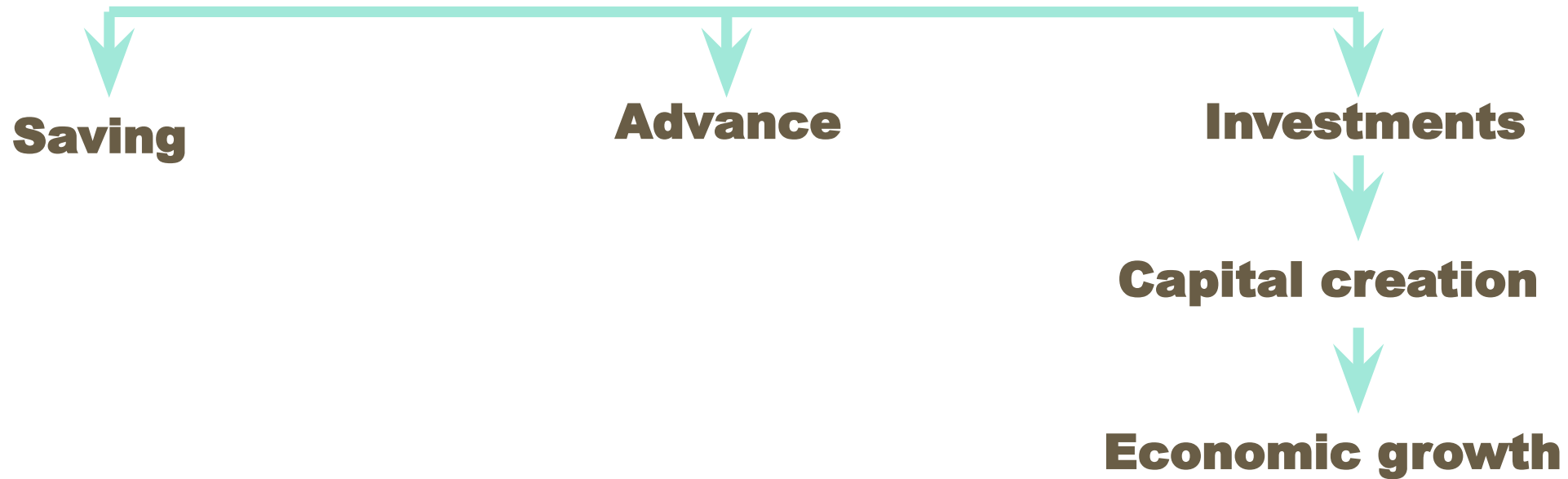
Definitions of financial system

- Financial system can be defined as follows,
“financial system is a group inter connected activities that functions for certain pre-determined goals. This includes savings, investments and financial markets, institutions, financial instruments and services affecting creation of capital as well as financial methods.

- (1.)van Horne says,” the purpose of financial system is to distribute savings in an economy effectively so that savings can be available to final consumers or users for realistic investment or consumption.
- (2.)Christy defines it as follow, the purpose of financial system is to distribute the supply of money into various economic activities and various sector in such a way that these financial means can be used effectively without unnecessary interference and without affecting the price level.

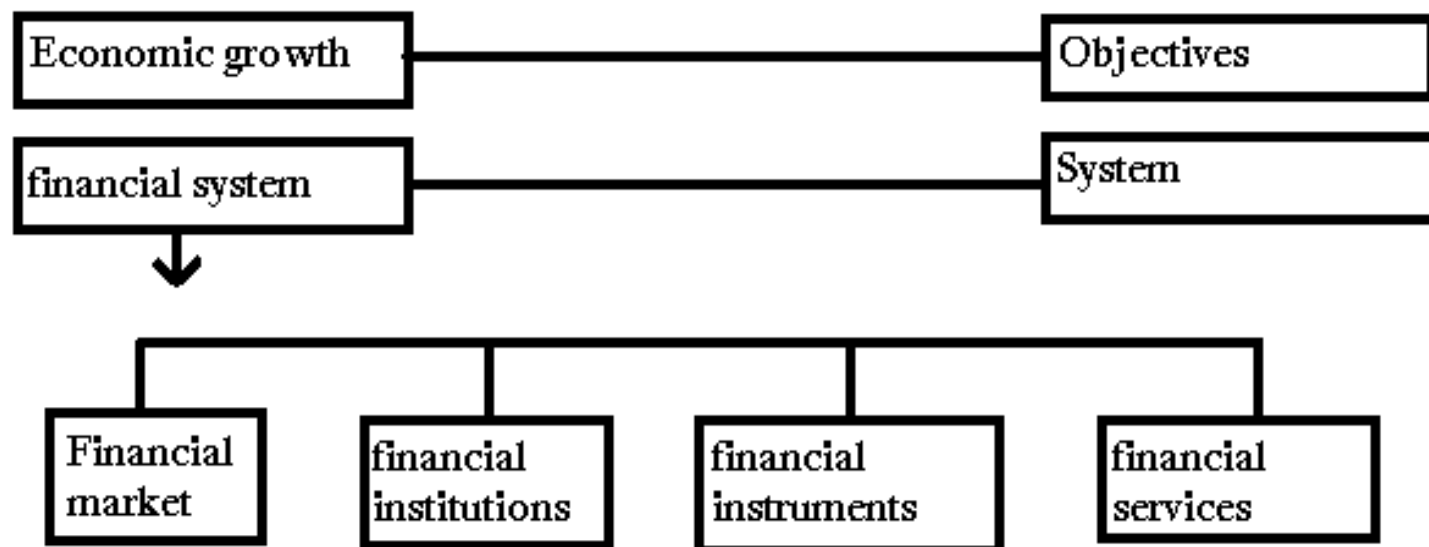
- According to Robinson, “the primary function of the financial system is to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composite of the existing wealth.
- Primary function of financial system is to activate savings for economic development by creation of wealth.

Financial system



- In the process of savings, advances and investments, financial institutions, money markets, instruments and services are included. All these require supervision, control and obedience to rules and laws. Therefore financial management is part of financial system.
- Goldsmith explains his view based on experiences, “the functions of savings and investment in financial system expands the scope of availability of financial instruments and financial assets. Thus, financial institutions become more efficient and creates wealth for financial activities and natural production which accelerate economic growth rate:

In this context, the interrelationships of financial system with various parts of economy can be shown as follows:



- Financial system provides essential services in modern economy. It provides stable and all accepted medium of exchange. The economic transactions become economically viable. In the field of production it provides the facilities of specialization and encourage trade. In developing countries, optimum use of resources, propensity to savings and taking risks have proved vital.
- Thus, financial system can be considered the most important representative of change. Moreover, it can be called the key input for development.

Type of financial system and its methods

- For rapid economic development, creation of capital is inevitable. For capital creation, financial is necessary. Financial system provides for collection of saving to be utilized for industrial investments. This important task of collective of saving is made in two ways :
 - (1) Direct financial system
 - (2) Indirect financial system

(1). Direct financial system:

- In direct financial system, savings are collected without intermediaries. In this methods, savings are accelerated efficiently in the following manner:
 1. Financial assets/ investments
 2. Brokers/ investment banks
 3. Secondary markets/ stock exchange

1. Financial assets/investments

- In direct financial system, financial assets and investments exinding money is basically important for development of financial technology. Many problems can be solved through them pertaining to basic financial system. The units that do not have adequate savings, can invest more than their saving through equity share, preference share, debenture etc.

- Thus, through direct financial system, due to existence of assets, saving does not remain unutilized with those who want to save and investors can create wealth by making profitable investment. They contribute to economic development in this manner.
- Of course, financial assets in the form of direct financial system is not enough for capital creation because the limitation of direct investment that the investors to negotiate with the class of people who wish to save.

(ii) Brokers/ investment banks

- Brokers and investment banks are another organ of direct financial system. The function of brokers is to find out those who want to save with investors. Brokers co-ordinates saving and investment and make efforts by offering incentives to those who wish to save their money.
- They channelis the flow of savings in the direction of investment. They contribute in chennelising the investment in the right direction.

(iii) Secondary markets stock exchange

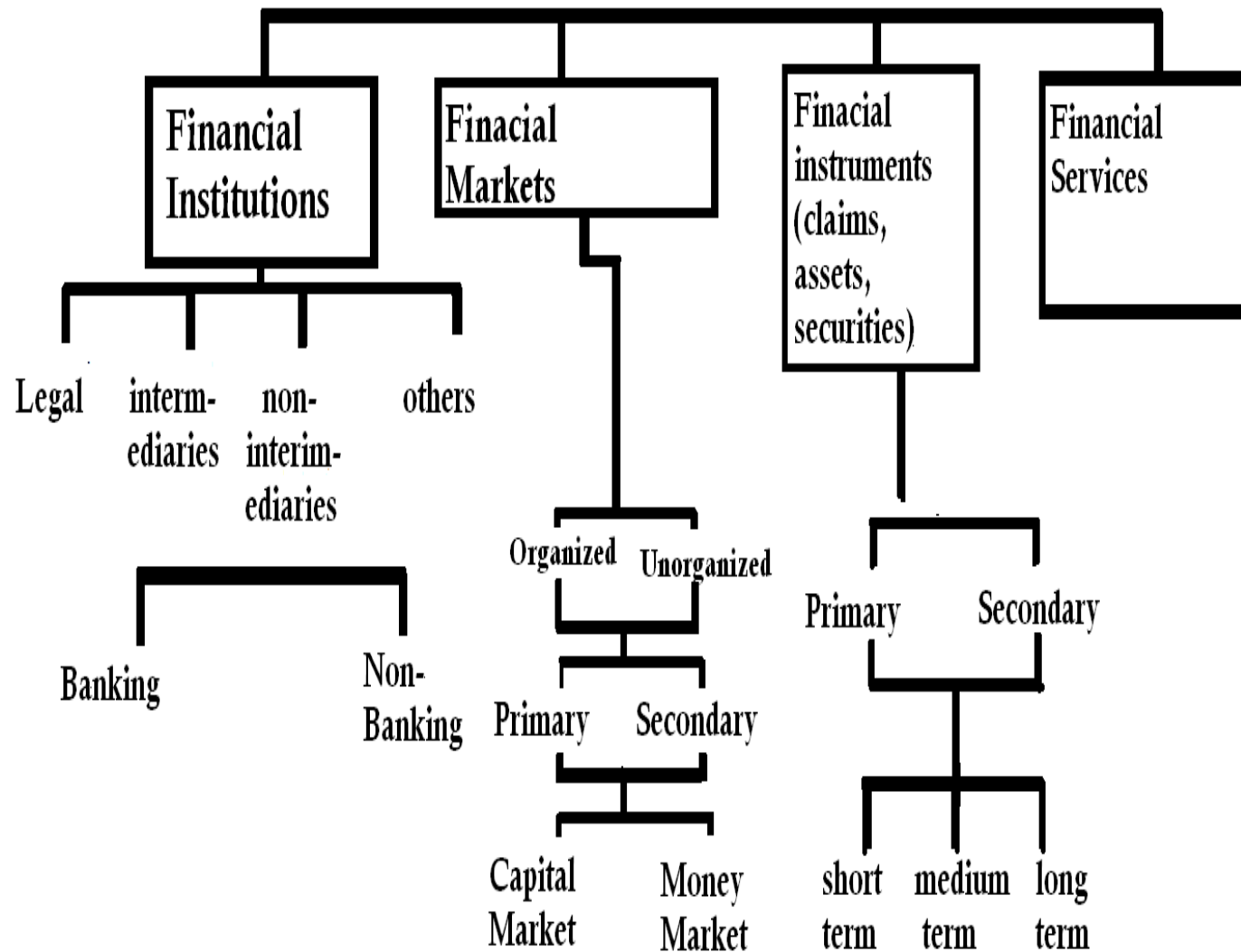
- The third important organ of direct financial system is stock exchange. It is called secondary market also. In this market also, there is regular trading of shares and securities. this market is very important for investors, because it fulfills the basic requirements of investors.

(2) Indirect financial statement

- In indirect financial system, there are intermediaries institutions like insurance companies, mutual funds etc who channelise the flow of the savers to the investors.
- The main difference here is that investors prefer the institution that work as agents for individual savers for financial negotiation.
- GOLDSMITH aptly (suitable) remarks that, “financial intermediaries present finance into attractive packages.”

- To accelerate savings, financial intermediaries provide numerous functions to savers for their financial assets. They are as follow:
- 1.) convenience
 - 1.) divisibility
 - 2.) creation of liquidity
- 2.) law risk
- 3.) expert management
- 4.) economies of scale

Components of financial statement



- *Thank you*