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The Problem and Condition of Indian Money Market

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Abstract: Money market refers to a mechanism whereby on the one hand borrows manage to obtain short term loanable funds and on the other, lenders succeed in getting creditworthy bowwowers for their money. In any money market, commercial banks are the most important lenders. These banks are however not merely the lenders of money they also create credit. The central bank's role is important as the controller of credit.

Introduction: The Indian money market is not an integrated unit. It is broadly divided into two parts. The unorganized and the organized market. There is compartmentalization between the two markets and as such the rates of interest differ in the unorganized from those in the organized sector. The unorganized sector of the money market comprises unregulated non-bank financial intermediaries, the indigenous bankers and money lenders. Money lenders, indigenous bankers and unregulated non-bank financial intermediaries who constitute this sector differ in many respects. Their organizations as well as the operations are not the same everywhere.Moreover, unlike modern banks there are little business relations between them. The organized sector on the other hand is fairly integrated. Both nationalized and the private sector commercial banks constitute the core of the organized sector. The foreign banks, cooperative banks and reserve bank of India, the discount and finance house of India, development finance institutions like IIBI and IFCI and investment finance companies like the LIC,GIC,and UTI and mutual funds are the other institutions which operate in the organized sector of the Indian money market. The RBI is the apex organization in the Indian money market. Since it is the leader and controller of the money market, it has great responsibility in respect of smooth functioning of the financial system. In April, 1988, the RBI set up the Discount and Finance House of India (DFHI) to perform the function of stabilizing the money market. Unregulated non bank financial intermediaries such as finance companies, chit funds, nidhis etc., indigenous bankers and money lenders operate in the unorganized sector of the Indian money market. Endings of the moneylenders are rather small but some finance companies, chit funds and indigenous bankers do a considerable amount of business. This chapter tries to highlight the conditions & the problems of Indian money marketing system and tries to find out the ways for solving it.

Keywords: Money Market, Loanable fund, Organized & unorganized market, Money lenders, Indigenous banks, Regulated market, Chit funds etc.

I. OBJECTIVES OF THE STUDY

The objectives of studies are as follows-

A. To study about the conditions of Indian money market and its problems which are confronted within the system?
B. To know about organized & unorganized sector of the money market.
C. To give real picture of total money marketing system
D. To suggest the measures of solving the problems of money marketing system.
E. To analyze the nature of the problems.
F. To put forward an ideal model for improving money marketing system and compare it total money marketing system in India.
G. To put forward the recommendations for developing Indian money marketing.

II. METHODOLOGY OF THE STUDY

The data will be collected from primary and secondary source in India. The primary data will be collected with the help of interview and survey method. The primary data will also be collected from a sample survey among the organized sectors like co-operatives banks,RRb's office ,foreign banks, investment finance institutions like LIC,GIC and UTI and Mutual funds and from the unorganized sectors such as finance companies, chit funds,nidhis,indigenous bankers,moneylenders,mahajons etc.The informations has been collected through observation of those sectors and by taking interview with the all employees of these sectors,producers,creditors,retailers,whole sellers of the market etc.The conclusion has been made on the basis of these informations and by analyzing the data this research paper has been formulated. For evaluating the objectives of the study the secondary data will be collected from the various sources such as books,reports,journels,websites,university libraries, planning commission,govt. publications(central and state),state and district wise statistical office, different banks & non banking institutions, various banking enquiry committees etc

Statement of the problem: In India there are several types non-beef unregulated financial intermediaries. Among these the most prominent are loan or finance companies, chit funds and nidhis.Loan companies are finance companies generally give loans to relatives, wholesale traders, artisans and other self-employed persons. The chit funds are savings institutions. They are of various types lacking any standardized form. A chit fund has regular members who make periodical subscriptions to the fund. The nidhis operate particularly in south India. They are in their character as some kind of mutual benefit funds because their dealings are restricted only to the members. Since the nidhis operate in the regulated credit market, there is hardly any information available about the amount of lending business done by them. Indigenous Bankers are individual or private firms which receive deposits and give loans and thereby operate as banks. They are various types like Gujarati Shroffs,Multani or Shikarpuri Shroffs,Chettiars and Marwari kayas.The indigenous bankers are engaged in non-banking business also and over the past few decades they have faced competition from the commercial and co-operative banks. Moneylenders do not constitute one homogeneous category. Broadly they are of two types: 1) Professional moneylenders whose main activity is money lending and 2) Non-professional moneylenders whose main source of income is not money lending. The organized sectors of Indian money market comprises the RBI, commercial banks, foreign banks, co-operative banks, finance corporations, mutual funds and the Discount and Finance House of India Limited(DFHI).The principal constituents of the organized sector of the Indian money market are i)The call money market ii)The treasury bill market iii)The repo market iv)The commercial bill market v) The certificates of deposits market vi) The commercial paper market and vii) Money market mutual funds. The call money market is an important segment of the money market where uncollateralized borrowing and lending of funds takes place on overnight basis. On the recommendation of the vaghul committee, the DFHI was set up in April, 1988; the DFHI was allowed to operate both as lender and borrower in the call money market. The UTI and the LIC were large lenders. The turnover and interest rates in the call money market generally reflect varying liquidity conditions. The market which deals in treasury bills is known as the treasury bill market. In India, treasury bills are short-term liability of the Central government. The Treasury bill market in India is very much undeveloped. Except the RBI, there are no major holders of treasury bills. They have been many types in use in recent years.i) 14-Day Intermediate Treasury bills ii) 14-Day Auction treasury bills, 91-day treasury bills, 182-day treasury bills, 364-day treasury bills. Repo rate is the rate at which Reserve Bank lends to the banks while reverse repo is the rate at which banks lend to the Reserve Bank. The commercial bill market is the sub-market in which the trade bills or the commercial bills are handled. Commercial bills as instruments of credit are useful to both business firms and banks. It is easier for the central bank to regulate bill finance through this. A certificate of Deposit (CD) is a certificate issued by a bank to depositors of funds that remain on deposit at the bank for a specified period.Thus, CDs are similar to the traditional term deposits but are negotiable and tradable in the short-term money markets. The Commercial Paper (CP) is a short-term instrument of rising funds by corporate, it is essentially a sort of promissory note sold by the issuer to a banker or a security house. It was introduced in 1990.A scheme of money market mutual funds was introduced by the RBI in April, 1992 to provide an additional short-term avenue to the individual investors. The MMMFs have been brought under the purview of the SEBI regulations since March 7, 2000.

Problems of Indian Money Market: In its organization and development, the Indian money market suffers from a number of defects of which are as follows-

1) *Lack of Intregation:* The Indian money market is divided into two sectors viz, the unorganized sector and the organized sector. As the two sectors are completely separate from each other, their financial operations are quiet independent and whatever goes on in one sector has little effect on the other. There is more competition than co-operation and co-ordination between various components of the Indian money market. The co-operative banks compete with the commercial banks, particularly in the countryside. Commercial banks not only compete among themselves but also with foreign banks. The indigenous bankers have no connections with RBI.This sorry state of affairs in the banking system is most regrettable in the context of development needs of the country. Even RBI's monetary policy has not been found sufficiently effective, and then it is the lack of adequate integration in the money market.
2) *Lack of Rational Interest rates Structure:* For a long time a major defect of the Indian money market has been lack of rational interest rates structure. This was particularly due to lack of adequate co-ordination between different banking institutions. The system of administered interest rates suffered in the past from a number of defects such as 1) Relatively low yield on government securities 2) certain concessional rates of interest 3) inappropriate deposit and lending rates of commercial banks.

These defects in administered interest rates led to a situation in the past in which there had always been excess demand for credit and the RBI had to depend often on cash reserve ratio changes to combat inflationary pressure. The number of administered rates on bank advances was reduced to 2% from 20% in 1989-90.Interest rate structure was also deregulated.

3) *Absence of an Organized Bill Market:* Only a limited bill market that has been created by the RBI under its schemes of 1952 and 1970 now exists but it has failed to popularize bill finance in this country. The popularity of cash credit and lack of uniformity in commercial bills proved to be serious obstacles to the development of a bill market.Moreover, due to the presence of inter-bank call money market commercial banks never felt the real necessity of an organized bill market.
4) *Shortage of Funds in the Money Market:* The Indian money market is characterized by shortage of funds. Invariably demand for loan able funds in the money market far exceeds its supply. This is happened to a variety of factors .In the first place, savings are small due to low per capita income. Secondly, inadequate banking facilities, lack of banking habit among the people and absence of ample and diversified investment opportunities had also contributed in the past to shortage of funds. As in the countryside banking facilities are still lacking, people have little option but to hoard their savings. Emergency of a parallel economy and vast amount of black money in the country have also caused shortage of financial resources in the money market. Now many branches of commercial and co-operative bank has been expanded which improve the mobilization of funds and helps in overcoming the stringency of funds to an extent, but no remedial measures are possible to remove scarcity of loanable funds in the money market caused by the acute poverty of the mass of population.
5) *Seasonal Stringency Of Funds And Flections In Interest Rates:* India being essentially an agricultural country, farm operations have also some bearing on the demand as well as the supply of funds in the money market. From October to June when farm operations and trading in agricultural produce require additional finance, a monetary stringency is created in the money market. Had the money market been sufficiently elastic and the supply of funds could be augmented more or less automatically in response to seasonal rise in the demand, interest rates would have been very much stable.
6) *Inadequate Banking Facilities:* The banking facilities in the country are still inadequate. Compared to USA where per 1200 persons there is a branch of a commercial bank, in India we have a branch on an average for roughly 15,900 persons due to the difference in the levels of development in the two countries. Most of the people of the country live below the poverty line and does not require any banking facility. Besides this most of the poor people in the countryside have no access to banking facilities.Mobilisation of small savings is both difficult & uneconomic which create great problem. In our country where every bit of savings is to be used for productive purposes, banking facilities have to be expanded.

Recommendations and measures for improving the Indian money market: The RBI and the government have taken various measures to strengthen the Indian market over the years which are as follows-

a) *Remitting The Stamp Duty:* In August 1989,the government remitted the stamp duty on usance bills which was considered a major administrative constraint in the use of bill system. This measure has failed to induce use of commercial bills. Unless effective measures are undertaken to discourage cash credit system, the government's decision to remit the stamp duty alone would not change the situation in favour of the use of bill system.
b) *Deregulation Of Money Market Interest Rates:* With effect from May 1,1989 the RBI deregulated money market interest rates which proved to be a significant step towards the activation of the money market. This was expected to make interest rates flexible and lend transparency to transactions in the money market.
c) *Introducing New Money Market Instrument:* Over the past to decades,four major money market instruments have been introduced.These are 182-day treasury bills,364-day treasury bills, certificates of deposits and commercial paper.182-day treasury bills were systematically promoted by the discount and finance House of India and were the first security sold by suction for financing the fiscal deficit of the central government.It also developed a secondary market in these bills and they became popular with the banks.Like 182-day treasury bills 364-day treasury bills can be held by the commercial banks for meeting Statutory Liquidity Ratio.CDs gained a considerable market in 1996-97.CPs as money market instrument are now more than twenty years old. The Indians' market is driven by the demand for CP by scheduled commercial banks which, in turn is determined by bank liquidity. The secondary activity is subdued in the Indian CP market due to most investors' preference to hold the instrument on account of higher risk-adjusted return relative to those of other instruments.
d) *Introduction of Repos And Reverse Repos:* They are an important development in the government securities market is the introduction of repos and reverse repos. These are instrument used for short-term liquidity management. Repo is the rate at which banks borrow from the RBI while reverse repo is used to drain excess cash lying with the banks. An increase in these rates signals a rise in interest rates. To tackle the problem of high inflation in the economy in recent times, the RBI has been hiking these rates on a regular basis. In its monetary policy in 2011-12, The RBI announced its decision to shift towards a single

policy rate-the repo rate. The reverse repo rate was pegged at 100 basis points below the repo rate.RBI also instituted a new marginal standing facility from which scheduled commercial banks can borrow overnight funds. This created a 200 basis points corridor with repo at the centre ,reverse repo 100 basis points below and MSF 100 basis points above the repo. Reverse repo rate is now pegged at 25 basis points below the repo rate and the MSF at 25 basis points above the repo rate.

e) *Setting up of the Discount and Finance House of India:* It was set up April 25, 1988. It's function is to bring into the fold of the Indian money market the entire financial system comprising of the scheduled commercial banks, foreign banks, co-operatives banks, all-India financial institutions in the public and private sectors so that their short term surpluses and deficits are equilibrated at market related rates/prices through inter-bank transactions in case of banks and through money market instruments in the case of banks and others. In DFHI operations, the emphasis is placed on a high turnover in the money market instruments rather than on being their repository.
f) *Introducing money Market Mutual Funds:* They were introduced in India in April 1991 to provide an additional short-term avenue to investors and bring money market instruments within the reach of individuals.
g) *Developing call/notice Money Market:* It was mainly an inter-bank market until 1990.Only the Unit Trust of India and the Life Insurance Corporations were allowed to operate as lenders since 1971.During the 1990s,the RBI's policy relating to entry into the call money market was liberalized to provide more liquidity. Banks and primary dealers are operating as both lenders and borrowers, while a number of non-bank financial institutions and mutual funds are operating only as lenders.
h) *Removing Constraints on Development of the term Money Market*: The term money market in India remained dormant for a long period of time. Statutory pre-emotions on inter-bank liabilities, cash credit system of financing, the regulated interest rates, availability of sector-specific refinance, the scarcity of money market instruments of varying maturities and the inadequate asset liability management (ALM) discipline among banks were the factors that inhibited the development of the term money market. Most of these constraints have been gradually removed by the RBI in recent years.
i) *Sector Specific Refinance Facilities:* Refinance is used by central banks to meet liquidity shortage in the system, to control monetary and credit conditions and direct credit to selective sectors. The RBI has used in the past a number of sector-specific refinance facilities of which export credit refinance and food credit refinance were the most prominent.

III. CONCLUSION

Though a base has been created with a variety of products in the money market, the market has not acquired the required depth in terms of both volume and liquidity. It is widely expected that the institutional and other reforms will provide the necessary depth in future. With that the Indian money market will get integrated with debt and foreign exchange markets and may pave the way for the RBI's increased use of indirect tools of monetary regulation.

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