Financial Intermediation and Markets

A growing economy needs investment to sustain its growth process. Such investments can be quickly and efficiently undertaken if investors have access to a well-developed financial market. Historically, banks have played the role of intermediaries matching savers with investors. However, the modern world of business requires a much more sophisticated level of intermediation. It is no longer sufficient to have an efficient means of allocating savers' funds to investors; one also needs financial markets to allocate risk and to re-allocate capital from inefficient to more efficient projects. Given the institutional nature of banks, it is not possible for them to provide all these functions of a modern financial market. Banks are one of the many players within a financial set up which has banks, insurance companies, pension funds, mutual funds, venture capital funds, and the stock and commodity exchanges. Together, they perform the various types of intermediation necessary in a global world.

5.2 Since 1991, when India had a bank-dominated financial market where the capital market was totally controlled by administrative officers, it has made remarkable progress to become one of the most developed financial markets among emerging economies. It still has a long way to go, but its current state of development is well reflected in the fact that there is a growing group of experts who want to see Mumbai as an international financial centre. Of more immediate significance to us, however, is how to use financial markets to enable everyone to participate in the growth process and distribute the process of wealth creation across all individuals. This chapter summarizes the major developments in this sector in India in the last year.