1. Describe the nature of the financial system in a modern economy giving the important types of constituent institutions, markets and instruments. Explain the concept of flow-of-funds in the financial markets.

**Ans:** A financial system refers to a system which enables the transfer of money between investors and borrowers. A financial system could be defined at an international, regional or organization level. The term “system” in “Financial System” indicates a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within a economy.

### Five Basic Components of Financial System

- Financial Institutions
- Financial Markets
- Financial Instruments (Assets or Securities)
- Financial Services
- Money
- Financial Institutions

Financial institutions facilitate smooth working of the financial system by making investors and borrowers meet. They mobilize the savings of investors either directly or indirectly via financial markets, by making use of different financial instruments as well as in the process using the services of numerous financial services providers.

They could be categorized into Regulatory, Intermediaries, Non-intermediaries and Others. They offer services to organizations looking for advises on different problems including restructuring to diversification strategies. They offer complete array of services to the organizations who want to raise funds from the markets and take care of financial assets for example deposits, securities, loans, etc.

### Financial Markets

A financial market is the place where financial assets are created or transferred. It can be broadly categorized into money markets and capital markets. Money market handles short-term financial assets (less than a year) whereas capital markets take care of those financial assets that have maturity period of more than a year. The key functions are:

1. Assist in creation and allocation of credit and liquidity.
2. Serve as intermediaries for mobilization of savings.