

Chapter One

Financial System

A financial system is a system that allows the exchange of funds between financial market participants such as lenders, investors, and borrowers. Financial systems operate at national and global levels. Financial institutions consist of complex, closely related services, markets, and institutions intended to provide an efficient and regular linkage between investors and depositors.

In other words, financial systems can be known wherever there exists the exchange of a financial medium (money) while there is a reallocation of funds into needy areas (financial markets, business firms, banks) to utilize the potential of ideal money and place it in use to get benefits out of it. This whole mechanism is known as a financial system.

Money, credit, and finance are used as media of exchange in financial systems. They serve as a medium of known value for which goods and services can be exchanged as an alternative to bartering. A modern financial system may include banks (public sector or private

sector), financial markets, financial instruments, and financial services. Financial systems allow funds to be allocated, invested, or moved between economic sectors, and they enable individuals and companies to share the associated risks

The components of a financial system

There are mainly four components of the financial system:

١- **Financial markets** - the market place where buyers and sellers interact with each other and participate in the trading of bonds, shares and other assets are called financial markets.

٢- **Financial assets** - the products which are traded in the financial markets are called financial assets. Based on different requirements and credit seekers, the securities in the market also differ from each others.

٣- **Financial institutions** - financial institutions are acting as a mediator between the investors and borrowers. They provide financial services for members and clients. It is also termed as financial intermediaries because they act as middlemen between the

savers and borrowers. The investor's savings are mobilized either directly or indirectly via the financial markets. They offer services to organisations who want to raise funds from markets and take care of financial assets (deposits, securities, loan, etc).

4- **Financial services** - services provided by assets management and liabilities management companies. They help to get the required funds and also make sure that they are efficiently invested.

(eg. banking services, insurance services and investment services)

Payment System

A payment system is any system used to settle financial transactions through the transfer of monetary value. This includes the institutions, instruments, people, rules, procedures, standards, and technologies that make its exchange possible. A common type of payment system, called an operational network, links bank accounts and provides for monetary exchange using bank deposits. Some payment systems also include credit mechanisms, which are essentially a different aspect of payment.

Payment systems are used in lieu of tendering cash in domestic and international transactions. This consists of a major service provided by banks and other financial institutions. Traditional payment systems include negotiable instruments such as drafts (e.g., cheques) and documentary credits such as letters of credit. With the advent of computers and electronic communications, many alternative electronic payment systems have emerged.

The term electronic payment refers to a payment made from one bank account to another using electronic methods and forgoing the direct intervention of bank employees. Narrowly defined electronic payment refers to e-commerce a payment for buying and selling goods or services offered through the Internet, or broadly to any type of electronic funds transfer.

Modern payment systems use cash-substitutes as compared to traditional payment systems. This includes debit cards, credit cards, electronic funds transfers, direct credits, direct debits, internet banking and e-commerce payment systems.

Payment systems may be physical or electronic and each has its own procedures and protocols. Standardization has allowed some of these

systems and networks to grow to a global scale, but there are still many country-specific and product-specific systems. Examples of payment systems that have become globally available are credit card and automated teller machine (ATM) networks. Other specific forms of payment systems are also used to settle financial transactions for products in the equity markets, bond markets, currency markets, futures markets, derivatives markets, options markets.

Additionally, forms exist to transfer funds between financial institutions. Domestically this is accomplished by using Automated clearing house and real-time gross settlement (RTGS) systems. Internationally this is accomplished using the SWIFT network.