International Journal of Marketing and Human Resource Management (IJMHRM)
Volume 13, Issue 1, January-April 2022, pp. 117–121, Article ID: IJMHRM_13_01_014
Available online at https://iaeme.com/Home/issue/IJMHRM?Volume=13&Issue=1
ISSN Print: ISSN 0976 – 6421 and ISSN Online: 0976 – 643X
DOI: https://doi.org/10.17605/OSF.IO/BD7WM

THE ROLE OF FINANCIAL INTERMEDIARIES IN EMERGING ECONOMIES

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ABSTRACT

Financial intermediaries at the center of the financial system have a role in re-allocating household unit excess resources to other financial units. The Savers desire a short-term loan, and the Borrowers want a long-term borrowing. From conventional banking, financial intermediaries have developed into more sophisticated intermediaries like investment banks, pension funds, venture capital funds, mutual funds and hedge funds because of market imperfections and information asymmetry. This article explains how financial intermediaries are playing a vital role in the financial Market

Key words: Financial intermediaries, saver, borrower, bank, financial advisors, credit union, mutual funds.

Cite this Article: Hue Nguyen Thi, The Role of Financial Intermediaries in Emerging Economies, *International Journal of Marketing and Human Resource Management (IJMHRM)*, 13(1), 2022, pp. 117–121.
https://iaeme.com/Home/issue/IJMHRM?Volume=13&Issue=1

1. INTRODUCTION

Along with the rapid development of the global economy, financial intermediaries play an extremely important role in the world financial market, as well as the emerging market. Financial intermediaries are organizations that mobilize idle capital from savers and then provide funds to those who have capital needs. Financial intermediaries include commercial banks, investment banks, mutual funds, and pension funds. The growing economy, along with the imperfections of the financial markets, has failed to meet the huge capital needs of the current economy. Financial intermediaries become an important capital channel for the economy - an indirect channel of capital. A healthy and vibrant economy needs a financial system to move capital from those with money to those with profitable investment opportunities. In this study, we will have a more general view of financial intermediation, and its importance in financial markets.

Financial intermediaries are entities that receive deposits and make loans indirectly, and at the same time link between entities and investors lending directly. This interlinking shows their complementary development. The development of financial intermediaries is conducive to the efficiency of financial markets. And the sustainable development of the financial market will create a favorable environment for financial institutions to operate. From the point of view of financial system, financial intermediaries and financial markets raise capital together. So, this study can facilitate to refer better understand about development of financial intermediaries

2. AN OVERVIEW OF FINANCIAL INTERMEDIARIES

Financial intermediaries have the fundamental errand of purchasing securities from borrowers, issuing bonds indirectly to lenders to accomplish financing purposes (John and Edward, 1960). Their principal function is to act as intermediaries for the exchange of income in addition to the use of entity. Executing this function will assist with further developing investment and reserve funds levels and expand the allocation of meager savings to existing investment projects. They additionally accept that borrowing, using, and joining financial intermediaries mean lower costs for loans, which corporate intermediaries can invest in or operate than most individuals. The enterprise can reduce risk greatly only by diversifying.

Financial intermediaries include bank, credit union, mutual funds, and financial advisors. A bank is a place that is allowed to receive deposits from people and create credit products for borrowers. Banks are heavily regulated by governments because of their role in economic stability. They are abiding as well by minimum capital requirements relied on one set of international standards (Basel Accords).

A credit union is a type of financial institution like a commercial bank, which is a member-owned financial cooperative, controlled by its members, and operated on a non-profit basis. Credit unions typically provide the same services to members as retail banks, including deposit accounts, credit facilities, and other financial services. Worldwide, credit union systems vary considerably in their total assets and average size of assets, from volunteering with a small number of members to organizations with hundreds of thousands of members. members and assets worth billions of US dollars.

Mutual fund is simply a collective investment model. Accordingly, the capital that the fund holds is usually mobilized from the public. After that, this capital will be reinvested in the purchase of bonds and securities.

To accomplish your goals, you may need a financial advisor to help make these plans a reality. This is when a person of expertise comes in. Another part of an advisor's job is to help you understand financial decisions. They start with simple things like budgeting and saving.

Figure 1 An overview of financial intermediary

3. THE ROLE AND FUNCTION OF FINANCIAL INTERMEDIARIES

3.1. The Role of Financial Intermediaries

Since the main activity of financial intermediaries is to gather idle capital in the economy to supply where there is a high demand for capital, financial intermediaries play an important role in financing capital for the economy. Financial intermediation benefits those who need capital, have excess capital, the financial intermediaries themselves and the whole economy. Financial intermediaries have three main roles as follows: a role in reducing costs, a role in reducing risks, and an indirect channel to help the state intervene in the economy.

When participating in the financial market, actors face two common problems: transaction costs and information costs. However, when transacting through financial intermediaries, financial intermediaries can solve this problem, minimizing the costs incurred in the transaction. In terms of transaction costs, if you are a small investor, when you need to invest, you will have to face costs such as brokerage fees, portfolio management costs, etc...and the larger your portfolio, the larger the costs, leading to a lower return on investment. However, financial intermediaries can mobilize small capital sources into large capital sources, they will reduce the cost per dollar of capital. Or a team of experts can advise or find good investment opportunities for customers. Thereby, subjects save transaction costs. In terms of information costs, financial intermediaries are professional organizations operating in the financial sector, so they have more experience and knowledge than individual lenders. As a result, they will collect and process information more efficiently, thereby assessing the level of risk more accurately.

In investment activities, there are many risks such as exchange rate risk, interest rate risk, payment risk, etc. With their large scale and professionalism, financial intermediaries can diversify their portfolios. investment item. They have the functions of monitoring the use of capital by borrowers to help reduce risks for investors and the financial intermediaries themselves. Small investors will be more secure when investing through financial intermediaries.

Financial intermediaries also act as a means for the state to implement appropriate monetary policy to stabilize the economy. The economy has been changed over the course of the years in an extremely perplexing manner (Alley 2001). For example, when the economy grows slowly, the recession slows down, the state can apply an easy monetary policy, through the purchase of securities from commercial banks. Ventures that address current useful powers will ultimately advance truly monetary and monetary turn of events (Feng and Sheng, 2012). At that time, an amount of money supply will be poured into the economy, creating pressure to reduce interest rates, reduce borrowing costs, and stimulate economic development. In the opposite case, when the market grows too hot and inflation rises, the government will apply a tight monetary policy through the sale of bonds on the open market, reducing the money supply and increasing interest rates, from that economic growth slows down.

3.2. Functions of Financial Intermediaries

Financial intermediaries have two main functions, namely, a capital conduction function and a control function.

Direct financial markets and financial intermediaries are the two main channels for financing the financial system. These two systems both have the function of directing capital from those who have idle capital to those who need it. However, when going through a financial intermediary, the person who needs capital and the person who has the capital do not need to meet directly, especially helping capital to move faster.

Financial intermediaries exercise their supervisory function to reduce the risks of adverse selection and moral hazard when making loans. Monetary business sectors limit costs for the intermediaries and their clients and permit them to support risks more effectively than they beforehand could (Allen 1999). To perform this function well, financial intermediaries must carefully check, collect, and process accurate information before lending, periodically control during lending and after lending.

The roles and functions of financial intermediaries are summarized in figure 2.

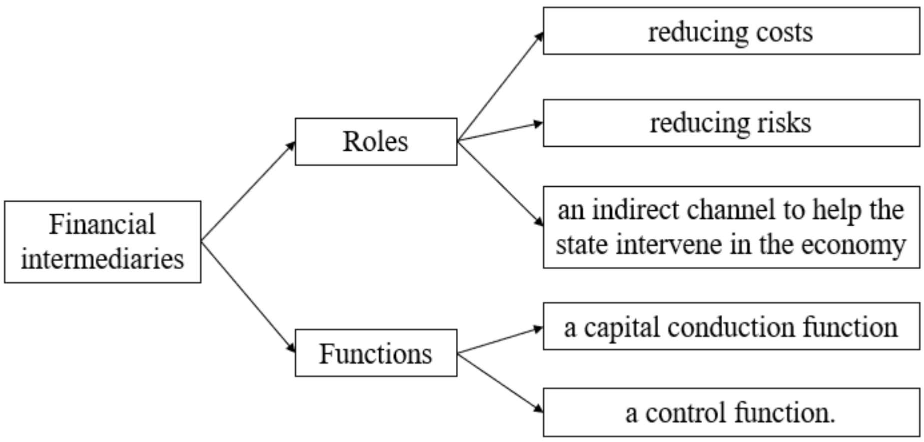

Figure 2 Summary of the roles and functions of financial intermediaries

4. STATUS OF FINANCIAL INTERMEDIARIES IN EMERGING ECONOMIES

Currently, the financial intermediation system of emerging economies has fully developed three main types: deposit-taking intermediaries, investment intermediaries and contract savings institutions. The mechanisms and policies on banking activities have become more and more complete and in line with international practices. Institutions are becoming more and more transparent. Credit institutions have been fully autonomous and accountable. The competitiveness of credit institutions is enhanced. The banking service market develops safely and effectively.

Monetary policy is renewed and operated according to market principles and in line with international practices. The interest rate and exchange rate policies are applied flexibly according to the market mechanism. Credit policy was expanded and renewed in the direction of creating fairness for all economic sectors, businesses, and each population.

5. CONCLUSION

In the financial market, financial intermediaries play an active role in sharing transaction risks, improving the efficiency of financial transactions. The existence of financial intermediaries is also essential. Financial intermediaries help cut transaction costs, reduce risks, and are an indirect channel for the state to intervene in the economy. The main function of financial intermediaries is as a capital conduction function and a control function. Today, the financial intermediary’s system is increasingly developed and gradually improved

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