# BALAJI INSTITUTE OF I.T AND MANAGEMENT KADAPA

## FINANCIAL INSTITUTIONS AND SERVICES (17E00308)

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## ICET CODE: BIMK

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**Units covered:** 1st, 2nd, 3rd, 4th & 5th UNITS

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**(17E00308) FINANCIAL INSTITUTIONS AND SERVICES**

**(Elective II)**

**Objective:** The objective of the course is to provide to students an understanding of Financial Markets, the major institutions involved and the services offered within this framework.

1. **Introduction**: The structure of financial system, Elements of financial system and economic development, Regulatory and Promotional Institutions - Function and Role of RBI, Monetary Policy and techniques of RBI,
2. **The Banking and Non-Banking Institutions:** The public and the private sectors – structure and comparative performance, Bank capital and Banking Innovations, Commercial and Co-operative banks. The Non-banking financial Institutions **-** Mutual Funds, Growth of Indian Mutual funds and its Regulation. The Role of AMFI, Insurance Companies- Role of IRDA.
3. **Financial and securities Markets:** Primary and Secondary Markets, Structure and functions of Money Market, -Call call money market, Government Securities Market – T-bills market, Commercial Bills market, Commercial paper and certificate of deposits. Securities markets**:** - Organization and structure, listing trading and settlement of securities market, The role and functions of SEBI
4. **Fund based services** - Lease and hire purchase consumer credit and Factoring - Definition, Functions, Advantages, Evaluation, venture capital financing, Housing Finance.
5. **Fee-based services** - Stock broking, credit rating, Merchant Banking, portfolio services. Underwriting, Depository services, Challenges faced by investment bankers.

**Text Books:**


- Financial Institutions and Markets, L. M. Bhole, 4/e Tata McGraw Hill.
- Financial services, Gorden& Natarajan, Himalaya publishers.


**References:**


- Financial Services and markets, Dr.Punithavathy Pandian, Vikas
- Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
- Indian Financial System, Ramachandra and others, HPH
- Investment Institutions and Markets, Jeff Madura, Cengage, 1st Edition.
- Financial services, Thirpati, PHI.
- Financial Markets &Services, Vasanthdesai, Himalaya.
- Financial Institutions and Markets, Gupta Agarwal, Kalyani publishers.
- Management of Financial Services, C.Rama Gopal ,Vikas.

# UNIT-1

# INTRODUCTION

## 1. THE STUCTURE OF FINANCIAL SYSTEM

- The economic development of any county depends upon the existence of a well organized financial system.
- It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promote the well being and standard of living of the people in a country.
- The major assets traded in the financial system are money and monetary assets.
- The responsibility of the financial system is to move the savings in the form of money and monetary assets and invest them to productive ventures.
- Thus the financial system acts as inter mediator between savers and investors for faster economic development.
- The evaluation of the Indian financial system mainly has three distinct phases.

1. The economic activities which are done up to 1951 i.e. before independence.
2. Between 1951 and the mid 1980's reelecting the imperatives of planned economic growth and
3. After the early nineties responding to the requirement of liberalizes / deregulated/globalised economic environment.

### 1.1 PHRASE-1 (PRE-1951)

- A traditional economy according to R.L. BENNETT is one in which the per capital output is low and constant.
- The principal features of the pre-independence, industrial finance organizations are in the closed circle.
- The industry had very restricted access to outside savings.
- The fact that the industry had no easy access to the outside savings, in another way of saying that the financial systems was not responsive to the opportunities for industry investment.
- Such a financial system was clearly incapable of sustaining a high rate of industrial growth, particularly the growth of new and innovating enterprise.

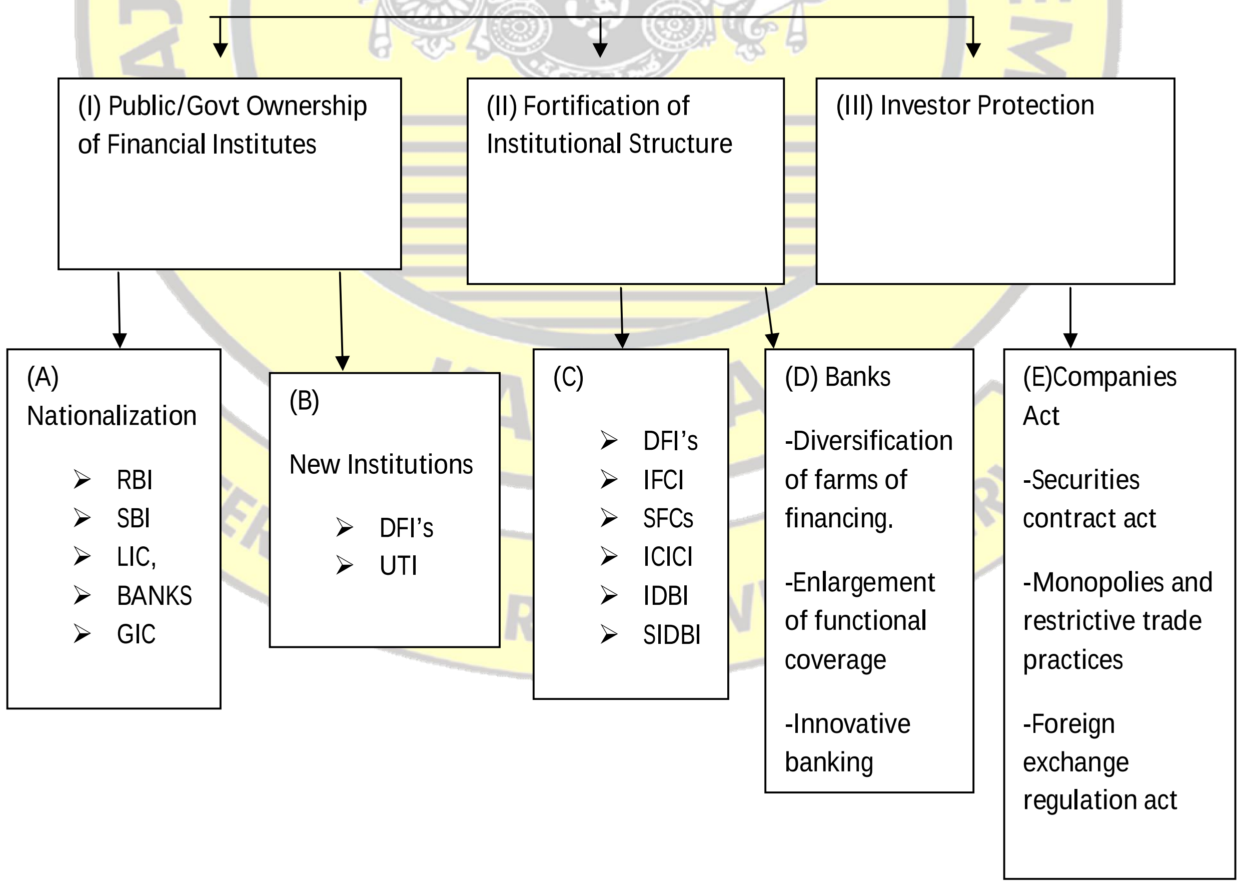
## 1.2 PHRASE – 2 (1951-MID 1980'S)

- The ability of the system to supply fiancé and credit to different companies in diverse forms was greatly strengthened during second phase.
- In this period the government starts different types of plans, introduction of 5 years plans etc.
- The main element of the financial organization in planned economic development could be categorizes into four broad groups.
  1. Public/government ownership of financial institutions.
  2. Fortification of the institutional structure.
  3. Protection to investors and
  4. Participation of financial institutions in corporate management.

## 1.3 PUBLIC OWNERSHIP OF FINANCIAL INSTITUTIONS

One aspect of the evolution of the financial system in India during this phase was this progressive transfer of its important constituents from private ownership to public control.

**Organization of Indian financial system**



**A. NATIONALIZATION**

- The nationalization of the Reserve Bank of India (RBI) is done in 1948 marked the beginning of the transfer of important financial intermediaries to governmental control this was followed by the state bank of India which was nationalized in 1956.
- In the year 1956,245 life insurance companies were nationalized and merged into the state-owned monolithic life insurance corporation of India (LIC).
- The year 1969 was a land mark in the history of public control of the private financial institutions, when 14 major commercial banks were brought under the direct ownership of the government of India.
- Yet another measure which deserves mention in this connection was the setting up of the general insurance corporation (GIC) in 1972
- Six more commercial banks were brought under the public ownership in 1980.

**B. NEW INSTITUTIONS**

- The government launches new institutions to control the government bodies. (Government Offices)
- In the first place a number of powerful special – purpose financial institutions designated as development banks/development finance institutions/term landing institutions were set up.
- A wide range of such institutions came into being some of which were national while others were regional / state level institutions and between them they covered the whole range of industry and provide finance.
- The public sector occupied a commanding position in the industrial financing system in India that is virtually the entire institutional structure was owned and controlled by the government.

**1.4 FORTIFICATION (Effectiveness) OF INSTITUTIONAL STRUCTURE.**

- The most significant element in the emergence of a fairly well-developed financial system in India during the second phase was the strengthening of its institutional structure.
- The fortification of the institutional structure of the Indian financial system was partly the result of modification in the structure and polices of the existing financial institutions.

**A. DEVELOPMET BANKS**

- The setting up of a variety structure of development banking/finance/term-lending institutions was the most outstanding development in this sphere.
- These developments banks could be appropriately designated as the back bone of the system of industrial financing in India.
- The structure of development banking consisted of both all India as well as state-level institutions.
- The setting up of the industrial finance corporation of India (IFCI) in 1948 marked the beginning of the era of development banking in India.
- State financial organizations (SFCs) were organized.
- National industrial development corporation (NIDC) was launched to provide both finance and entrepreneurship.

- Industrial credit and Investment Corporation of India (ICICI) Ltd in 1955.
- The government of India set up Refinance Corporation of industry (RCI) in 1958 to provide refinance to the banks against term loans granted by them to medium/small enterprises. This facility was later extended to the state financial corporations. The RCI subsequently merged with the industrial development bank of India (IDBI) in 1964.
- Industrial development in the direction of fortifying the structure of the industrial financing organization in India during this phase, the beginning of the life insurance corporation (LIC) in 1956 as a result of the amalgamation(merging) of 245 life insurance companies into a single monolithic state owned institution.
- UTI the establishment of the Unit Trust of India in 1964 was to enable to the small investors to share in industrial prosperity through indirect holding of equity and to mobilize the saving of the relatively small investors who numerically formed the major section of the saving populace (Common People).

**B. DIVERSIFICATION IN FORMS OF FINANCING**

Since the mid-sixties the commercial banks in India were officially encouraged to enter new forms of financing of which two deserve specific mention are as follow.

(i) Term lending and
(ii) Underwriting of new issues of corporate securities by industrial enterprise.

**(i) TERM LENDING**

- The introduction of formal term loans by commercial banks in India represented a radical departure from their traditional role of suppliers of short-term credit.
- Under this scheme the lending banks were provided refinancing facilities against approved term loans from the refinance corporation of India (RCI) LTD specially created for the purpose.
- The RCI was merged with industrial development bank of India on Sept-1-1964.

**(ii) WRITING OF NEW ISSUES OF CORPORATE SESCURITIES UNDER**

- The banks also widened their range of financial assistance to the industry partly through direct subscription of the company shares and debentures of corporate enterprise and partly through their lending against such securities.

**1.5 ENLARGEMENT OF FUNCTIONAL COVERAGE**

- The commercial banks were further directed to channelize their resources to small - scale industries and agriculture that is neglected sectors of the Indian economy.
- The flow of credit into these desired channels further symbolized the attempts to secure the alignment to bank credit with planning priorities the policy and institutional measure stimulate bank credit to these sectors are described below
  - (i) Small-scale industries.
  - (ii) Exports.
  - (iii) Agricultural finance.

**(i) SMALL – SCALE INDUSTRIES**

- Three measures were taken in the sphere of channelization of bank fund.
- First place, a systematic study of the problems involved was made and small-scale industrialist and bankers were brought together at a seminar on financing of small-scale industries organized by the RBI Hyderabad in 1959 with an aim to finding their solutions.
- Secondly in pursuance of the suggestions made at the Hyderabad seminar the government formulated a credit guarantee scheme in consultation with the RBI in July 1960 to guarantee the major part of the advances given by banks to the small scale industries.
- Finally, in its credit policy the RBI introduced a policy of granting additional rights to the banks to borrow from it at concessional rates.

**(ii) EXPORTS**

- An important measure taken to facilitate credit for exports was the set up of the export risk insurance corporation in 1957 to offer incurrence to exports against exchange controls or multi currency practices.
- In 1964 it was renamed as the Export Credit and Guarantee Corporation (ECGC) ltd.

**(iii) AGRICULTURAL FINANCE**

- The agricultural refinance corporation was set up as a subsidiary of the RBI in 1963 for providing medium and long term finance to eligible financial institutions, banks for promoting the development of agriculture and allied activities by way of refinance.

## 1.6 INNOVATING BANKING

- The period after the; mid-sixties to the early nineties may be aptly described as the phase of innovative banking or evolutionary phase or the beginning of the big change.
- The main features of this phase were,

  (i) Social control.
  (ii) Nationalization.
  (iii) Bank credit to priority sectors.

- Under social control the main changing concepts and goals of banking were drastically modified and so many rules are brought by government, government of India started programmers like Agriculture Refinance and projects for irrigation.
- Under nationalization the banking system had taken several measures for achieving the objectives of social control 14 major banks with individual deposits exceeding Rs 50 crore were nationalized on 19-july-1969 and in 1980 again 6 banks were nationalized.
- Priority Sector Lending is an important role given by the Reserve Bank of India (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors like agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.. This is essentially meant for an all round development of the economy as opposed to focusing only on the financial sector.

**1.7 INVESTOR PROTECTION**

- To safeguard the investors who had investment in the companies the government frame some legislative codes i.e.

    (i) Companies act 1956.
    (ii) Capital issues (control) act 1947.
    (iii) Securities contracts (regular)act 1956.
    (iv) Monopolies and restrictive trade practices act. (MRTP Act)
    (v) Foreign exchange regulation act.

- Under Companies Act, 1956 represented on important stage in the development of corporate enterprise in India. The underlying objective was the protection of the interest of prospective share holders. The law was further amended from time and time.
- Under Capital Issues Act the main element in the scheme is to providing protection to the investing public. The act was implemented through the controller of capital issues (CCI), which is in the hands of ministry of finance.
- The Securities Contracts (Regulation) Act, 1956 Act was enacted in order to prevent undesirable transactions in securities and to regulate the working of stock exchanges in the country. The provision of the Act came into force with effect from 20th February, 1957. The main objective of this act was to have a healthy and strong investment market in which the public could invest their savings with full confidence.
- Under Monopolies and Restrictive Trade Practices Act the main objective is to central such monopolistic and restrictive trade practices that were injurious to the public welfare, this act come in force from june-1-1970.
- Under Foreign Exchange Regulation Act 1973 regulated foreign investment with the aim of diluting the equity holding in foreign companies. It was also a step in the direction to create confidence among the investing public in industrial securities.

## 2. ELEMENTS/STRUCTURE OF FINANCIAL SYSTEM

The financial system consists of four elements or components. These are financial institutions financial markets, financial instruments and financial services.

**Financial system**

| (I) Financial Institutions/Intermediaries | (II) Financial Markets | (III) Financial Assets / Instruments | (IV) Financial Services |
|---|---|---|---|
| 1) Regulatory | 1) Money Market | 1) Primary Financial Instruments. | 1) Fund-Based Services |
| 2) Intermediaries | 2) Capital Market | 2) Secondary Financial Instruments. | 2) Fee-Based Services |
| 3) Non Intermediaries | 3) Foreign Exchange Market. | | |
| | 4) Derivative Market. | | |

### 2.1 FINANCIAL INSTITUTIONS/INTERMEDIARIES

Financial institutions are business organizations that act as mobilisers and depositories of savings and as purveyors (someone who supply what is needed) of credit of finance.

Types of financial institutions

**(i) REGULATORY:**

- Regulatory financial institutions are SEBI, IRDA, and RBI, AMC etc. before investors lend money, and they need to be reassured that it is safe to exchange securities for funds. These bodies will go through different markets and frames the rules and regulations.
- For example – the RBI regulates the money market and (SEBI) securities and exchange board of India regulates capital market.

**(ii) INTERMEDIARIES**

- Intermediaries supply only short term funds to individuals and corporate customers. They consist of banking and non bank in intermediaries.
- For example, banks like SBI, PNB will provide finance to other financial institutions and examples of non-banking intermediaries are LIC, UTI, and GIC etc. will provide financial services that are vital for creation of firm’s expansion and economic growth.

**(iii) NON INTERMEDIARIES**

- These non intermediaries mainly provide long term funds to individuals and corporate customers. They consist of term lending institutions like financial corporations and investment institutions like NABARD, IDBI, and IFCL etc.

## 2.2 FINANCIAL MARKETS

- Generally speaking, there is no specific place or location to indicate a financial market. Whenever a financial transaction takes place it is deemed to have taken place in the financial market.
- However financial markets can be referred to as those centers and arrangements which facilitate buying and selling of financial assets, claims and services.

### TYPES OF FINANCIAL MARKETS

**(I)** **The Money Market** is where financial instruments with high liquidity and very short maturities are traded. It is used by participants as a means for borrowing and lending in the short term, with maturities that usually range from overnight to just under a year.

**(II)** **Capital Market** – the term capital market refers to the institutional arrangement for facilitating the borrowing and lending of long-term funds.

**(III)** **Foreign Exchange Market**

- The foreign exchange (currency or FOREX or FX) market refers to the market for currencies.
- Transaction in this market typically involves one party purchasing a quantity of one currency in exchange for paying a quantity of another.
- The FX market is the largest and most liquid financial market in the world includes trading between large banks central banks currency speculators, governments and other institutions.

**(iv) Derivative Market**

- A **derivative** is a financial security with a value that is reliant upon or derived from an underlying asset or group of assets. ... Its price is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and **market** indexes. Example – currency marks i.e. forex markets.

## 2.3 FINANCIAL ASSETS/INSTRUMENTS

- A financial instrument is a claim against a person or an institution for the payment at a future date a sum of money and / or a periodic payment in the form of interest or dividend.
- Financial instruments play an important role of channelizing funds from lenders to borrowers.

**TYPES OF FINANCIL INSTRUMENTS**

**(i) PRIMARY FINANCIL INSTRUMENT**

These instruments are also termed as direct securities as they are directly issued by the ultimate borrowers of funds to the ultimate savers.

Example- equity shares, debentures etc.

**(ii) SECONDARY FINANCIAL INSTRUMENTS**

They are also referred to as indirect securities as they are issued by financial intermediaries to the ultimate savers.

Example – bank deposits, mutual funds units, insurance policies etc.

**2.4 FINANCIAL SESRVICES**

Financial intermediaries provide key financial services such as merchant banking, leasing, hire purchase, creditor-rating and so on.

These services are of two types

a) Fund based
b) Fee-based services

**a) FUND BASED/ASSETS BASED SERVICES**

- Fund based financial/services are financial method that is driven by the assets of companies.
- Assets include current assets, such as accounts receivable and inventory and fixed assets such as plant and machinery. For example- lease consumer credit and hire purchase.

**b) FEE-BASED SERVICES**

- Fee based financial services do not create immediate funds they enable the creation of funds through their services for which they charge a fee.
- For example – stock broking, credit rating and mutual funds policies etc.

**3. ECONMIC DEVELOPMENT**

- The role of financial system in economic development has been a much discussed topic among economists.
- As economists think, one view of economist holds that finance is not important at all and the opposite peoples view regards it to be very important.
- Economic development or economic progress has been defined in two ways.

(i) Economic growth means growth of national income of the country.
(ii) Economic growth means the increase in per capita income of the country at constant price.

**i) ECONOMIC GROWTH MEANS GROWTH OF NATIONAL INCOME OF THE COUNTRY**

- It implies an increase in the net national product in a given period say a year. Some economists argue that even if the national income goes up the general standard of living may go down; this can happen if population of the country is rising more rapidly than the growth of national income.

- If the national income is rising at the rate of 2% and population is increasing at the rate of 3% the level of living of the people is bound to go down.
- The country will have registered economic growth only if per capital income has gone up and this will happen only if the national income grows at a higher rate than the growth rate of the population.

ii) **ECONOMIC GROWTH MEANS THE INCREASE IN PER CAPITAL INCOME OF THE COUNTRY AT CONSTANT PRICES**

- The economic growth means the increase in per capital income of the country at constant prices. A higher per capital income would mean that people are better off and enjoy a higher standard of living.
- The raise in the standards of people should be there for long term long time but not for the short term then only there will be economic growth.

## 3.1 ROLE OF THE FINANCIAL SYSTEM IN THE ECONOMIC DEVELOPMENT

Following are some role of financial system which state that it helps in the economic development of country,

(i) Saving mobilization.

**Mobilization of savings**: More individuals throughout their lives have a need for **savings** deposits services rather than credit. **Savings** therefore offer significant leverage for economic development and self-sufficiency and are valuable to both microfinance institutions and their clients or members.

(ii) Investment.

In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or will later be sold at a higher price for a profit. Taking an action in the hopes of raising future revenue can also be considered an investment.

(iii) Banking systems.

A **banking system** is a group or network of institutions that provide financial services for us and for organizations. These institutions are responsible for operating a payment system, providing loans, taking deposits, and helping with investments.

(iv) National growth.

Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP.

(v) Monetary policy.

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and the government of a country will use to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.

(vi) Entrepreneurship growth.

The capacity and willingness to develop organize and manage a business venture along with any of its risks in order to make a profit. The most obvious example of entrepreneurship is the starting of new businesses.

## 3.2 STAGES OF ECONOMIC DEVELOPMETN

Prof. ROSTOW an eminent economic historian and a specialist in economic development has divided the historical process of economic growth into three stages,

1. Preparatory stage.
2. The take – off period and.
3. The period of self-sustained growth.

### a) PREPARATORY STAGE (STARTING STAGE)

- It covers a long period of a century or more during which the precondition for take-off are established. These conditions mainly comprise fundamental changes in the social political and economic fields.

**EXAMPLE**

- A change in society's attitude towards science, risk-taking and profit caring.
- The adaptability of the labor force.
- Political sovereignty.
- Development of a centralized tax system.
- Construction of certain economic and social overheads like railroads and educational institution.

### b) THE TAKE-OFF PERIOD

- This stage covers a relatively brief period of two or three decades in which the economy transforms itself in such a way that economic growth subsequently takes place more or less automatically.
- The term take-off implies three things firstly; the proportion of investment to national income must rise from 12-15% definitely outstripping the likely population increase. Secondly the period must be relatively short so that it should shoe the characteristics of an economic revelation and thirdly it must culminate in self- sustaining and self-generation economic growth.

### c) PERIOD OF SELF-SUSTAINED GROWTH

- It is a long period of self-generating and self-propelling economic growth. The rates of saving and investment are of such magnitude that economic development becomes automatic.

- Overall capital per head increases as the economy matures. The structure of the economy changes increasingly.
- The investments will grow automatically.

## 4 REGULATORY AND PROMOTIONAL INSTITUTIONS

### 4.1 PROMOTIONAL INSTITUTIONS

These are the institutions which will help the institutions in getting of money or to motivate firms with new plans.

### 4.2 REGULATORY INSTITUTIONS

- Regulatory institutions are the institutions that will ensure that firms will provide the goods and services promised and that their behaviors in general conform to established standards in the country/abroad.
- In India there are two powerful regulatory bodies those are

  a) RBI – This controls the banking and non banking systems in India.
  b) SEBI – Securities exchange board of India.

### a) RESERVE BANK OF INDIA (RBI)

- RBI commenced its operations on 01-04-1935 in accordance it RBI act 1934.
- The paid up capital of RBI was 5crore.
- The RBI was nationalized on Jan-01-1949.
- The reasons for nationalization of RBI are,

  1) There was a trend in the world that all the countries are making their central banks as nationalization.
  2) Even the bank of England was nationalized in 1946.
  3) After the Second World War the inflation tendency was also increased throughout the world.
  4) The Unorganized sector area collecting huge amount of interest rates from the people.

- The central bank was an independent apex monetary authority which regulates banks and provides important financial services.
- The functions of central bank vary from countries to countries.
- The reserve bank of India which controls the monetary policy of the Indian rupee.

### 4. FUNCTIONS/OBJECTIVES OF RBI

1. To manage the monitory and credit system of the country.
2. To stabilizes internal and external value of rupee.
3. For balanced and systematic development of banking in the country.
4. For the development of organized money market in the country.

5. For proper arrangement of agriculture finance
6. For proper arrangement of industrial finance
7. For proper arrangement of public debts.
8. To establish monetary relations with other countries of the world and international finance institutions.
9. For centralization of cash reserves of commercial banks.
10. To maintain balance between the demand and supply of currency.

**4.1 ROLE OR FUNCTIONS OF RESAERVE BANK OF INDIA (RBI)**

The performed by the reserve bank can be classified into two categories.

**ROLE OF FUNCTIONS OF RESERVE BANK OF INDIA**

**RBI**

| Monetary functions | non-monetary functions: Regulatory functions | non-monetary functions: promotional functions |
|---|---|---|
| -Issue of Bank Notes | -Provide license | -Established the bill market scheme |
| -Banker to government | -Coverage of bank operations | -Development of spcial-ised finance institutions |
| -Bankers bank | -Liquidation of weak banks | -Promote regional rural banks. |
| -Lender of the last resort | -Branch expansion | -establishment of export import bank of India. |
| -Custodian of foreign exchange Reserves. | -Issue directions on credit control | -Promotes research |
| -Credit control | -Training of bank personals | |
| | -Restrict loans & advances | |
| | -Collect & supply information | |
| | -Spreading banking habits | |
| | -KYC norms | |
| | -Transparency norms | |
| | -Audit and Inspection | |
| | -Risk management | |

## A. MONETARY FUNCTIONS

### 1. ISSUE OF BANK NOTES

The RBI has the sole of rights to issue bank note of all denominations (except one rupee motes which are issued only by the government of India)

This has been done to give the reserve bank the complete and uniform control over the currency and the credit system of the country.

The issue department of the reserve bank has its office in 17 important cities of the country.

### 2. BANKER TO GOVERNMENT

The RBI acts as the banker to government. It accepts money for the account of union and state government in India, makes payment on their behalf carries-out their exchange remittance and other banking operations.

It makes ways and means advances to the government for 90 days.

### 3. BANKERS BANK

The RBI acts as the banker's bank in the following respects.

Every bank is under the statutory obligation to keep certain to keep a certain minimum of cash reserves with the reserve bank.

The purpose of these reserves is to enable the reserve bank extend financial assistance to the scheduled banks in times of emergency and thus to act as the lender of the last resort.

The reserve bank provides financial assistance to the schedules banks by discounting their eligible bills and through loans and advances against approved securities.

Under the banking regulations act 1949 and its various amendments, the reserve bank has been given extensive powers, supervision and control over the banking system.

### 4. LENDER F THE LAST RESORT

Central bank helps commercial banks in time of difficulties. A commercial bank may experience difficulties whenever there is a sum on it (i.e.) when all depositors meant to withdraw their deposits at the sometimes).

It can borrow from other commercial bank but other bank may not be prepared to help the bank in trouble.

There is one bank which can be approached always i.e. RBI.

### 5. CUSTODIAN OF FOREIGN EXCHANGE RESERVES

The RBI has the responsibility of maintaining the external value of the rupee and for this purpose the bank holds most of the foreign exchange reserves.

Since India is a member of international monetary fund the RBI has to maintain fixed exchange rates with all other member countries of the fund.

**6. CREDIT CONTROL**

Credit control is an important tool used by the RBI a major weapon f the monetary policy used to control the demand and supply of money in the country.

The following are the results when the RBI controls the monetary policy.

(i) To encourage the overall growth of the priority sector i.e. those sectors of the economy which is recognized by the government as prioritized. (Agriculture and allied sectors and micro industries etc.)

(ii) To keep a check over the channelization of credit so that credit is not.

**B. NON-MONETARY FUNCTIONS**

It is divided as

a. Regulatory/supervisory functions and

b. Promotional functions

**a. REGULATARY FUNCTIONS**

The various powers vested in the RBI are as follows,

**1. PROVIDE LICENCE**

The RBI after being satisfied that it will be in a position to pay claims of the deposits as and when they accrue and that its affairs are being conducted in a manner the interest of its depositors will grant the license to the bank to commence banking business in India.

**2. COVERAGE OF BANK OPERATIONS**

The banks should maintain minimum paid-up capital reserves cash reserves and other liquid assets depending upon the geographical coverage of a bank's operations.

The RBI will see the fulfillment of these requirements.

**3. LIQUIDATION OF WEAK BANKS**

To strengthen the public banks at the time of low liquidation the RBI will infuse the money or merge the banks in to one. It may also for the suspension of business.

**4. BANK EXPANSION**

Every bank in the country is required to obtain permission from the RBI for its brand expansion programmed.

The RBI can also direct a bank to open branches in a particular area.

**5. ISSUE DIRECTIONS ON CREDIT CONTROL**

In order to improve the sartorial distribution of bank credit in favor of the priority sectors such as agriculture, small scale industry, self-employed persons etc, and make more of its to the small borrowers. The RBI can issue directions to commercial banks through its credit control.

**6. TRAINING OF BANK PERSONNEL**

The RBI gives training to different categories of bank personal by setting up a number of training institutes in the country.

The principal training institutions are bankers training college (Mumbai).

The national institute of bank management (Mumbai).

The college of agricultural banking (Pune).

Staff training college (Chennai).
Zonal training centre for staff at Mumbai, Kolkata, Chennai, and New Delhi.

7. **RESTRICT LOANS AND ADVNCES**

   The RBI has power to restrain control exercised by particular groups of persons over the affairs of banks and to restrict loans and advances as well as guarantees given by banks to and on behalf of anyone company, firma and individuals.

8. **COLLECT AND SUPPLY INFORMATION**

   The RBI has power to collect the information from many bank or other financial institutions to their constituents and supply these banks and institutions such information on applications in a consolidate form.

9. **SPREADING BANKING HABITS**

   The RBI has taken huge steps to spread banking habits throughout the country especially to the remote areas. It has introduced so many programmers like financial inclusion zero accounts etc, giving awareness about the banking systems, steps to improvise internet banking and mobile banking etc.

10. **KYC (KNOW YOUR CUSTOMER) NORMS**

    The main aim of KYC norms is to crub money laundering and prevents the use of banking system for financial crimes. Every bank should be going through the KYC forms before a person is going to open account.

11. **TRANSPARENCY NORMS**

    This means that every bank has to disclose their charges for providing services and customers have the right to know these charges.

12. **AUDIT AND INSPECTION**

    The procedure of audit and inspection controlled by the RBI through off-side and on-site mentoring system. On-site inspection is done by the RBI on the basis of CAMELS (capital adequacy, asset quality, management, earning, liquidity, system and control)

13. **RISK MANAGEMENT**

    The RBI provides guidelines to banks for taking steps that are necessary to mitigate risk. They do this through risk management in base norms.

**b. PROMOTIONAL FUNCTIONS**

The RBI has a great resposnsibiltiy to develop and promotion the monetary authority. The promotion steps taken by the RBI are,

1. Established the bill market scheme.
2. Promotion of commercial banking.
3. Promotion of co-operative credit.
4. Development of specialized financial institutions.
5. Promote regional rural banks (RRBs).
6. Promote national housing bank.
7. Credit to weaker selections.

8. Establishment of export import bank of India.
9. Promotes research.

**1. ESTABLISHED THE BILL MARKET SCHEME**

This scheme was introduced in the year 1952; it will extend loans to the commercial banks against their demand promissory notes. This scheme was not based on the genuine trade bills.

In 1970 RBI introduced new bill market scheme which covered the genuine trade bills related to sale or dispatch of goods.

**2. PROMOTION OF COMMERCIAL BANKING**

The RBI plays a vital role in strengthening the banks for good economic development. RBI has been using these powers.

(i) It improves their operational standards.
(ii) To extend the banking facilities in the semi-urban and rural areas.
(iii) To promote the allocation of credit in favor of priority sectors such as agriculture small-scale business etc.

**3. PROMOTION OF CO-OPERATIVE CREDIT**

With the recommendations of the rural credit survey committee the reserve bank has taken a number of measures to strengthen the structure of co-operative credit institutions throughout the country.

**4. DEVELOPMENT OF SPECIALISED FINANCIAL INSTITUTIONS**

RBI with help of other committee's suggestions taken the step to introduce some specialized financial institutions like IFCI (industrial finance corporation of India, UTI (Unit trust of India) NABARD (national bank for agriculture and rural development) SFCs (state financial corporation's)

These institutions will provide loans to their priority sectors.

**5. PROMOTE REGIONAL RURAL BANKS**

It has promoted regional rural banks (RRBs) with the co-operation of the commercial banks to extend banking facilities to the rural areas.

**6. PROMOTE NATIONAL HOUSING BANK**

It was launched in 1988 as it wholly – owned subsidiary to organize and argument resources for housing.

The national housing bank will provide loans to the institutions engaged in housing finance and also extend its full support to industries that supplies the building materials.

7. **CREDIT TO WEAKER SECTIONS**

The RBI has taken certain measures to support weaker sections in the society. It provides some different rate of interest scheme for the socially back word persons who engage in productive activities.

8. **ESTABLISHMENT OF EXPORT IMPORT BANK OF INDIA**

It helps the exporters who are facing problems in finance. It also helps the commercial banks of provide financial assistance to the persons who are related to finance problems.

9. **PROMOTES RESEARCH**

RBI encourages and promotes research in the areas of banking like mobile banking applications UID based banking system and internet banking etc.

## 6. MONETARY POLICY

- Monitory policy is an activity by which the central bank of the nation controls the availability of credit facility to its citizens.
- Monetary policy is a major weapon to control the development of a country.
- There are two types of policies that are pushed to combat the inflationary and deflationary tendencies in the economy. These are stabilization policies which mainly includes,
    1. Monetary policy.
    2. Fiscal policy.
- In this we will discuss about monetary policy. In monetary policy there are two kinds

a. **General/quantitative controls.**
b. **Selective/qualitative controls.**

**MONETARY POLICY TECHNIQUES**

1. General / quantitative controls

-Bank rate
-Open market operations
-Variations in the reserve requirements
-Repo rate and reserve repo rate
-Liquidity adjustment facility

2.selective/qualitative controls

-Credit rationing
-Margin requirement
-Variable interest rate
-Regulation of consumer credit licensing

**1. GENERAL OR QUANTITATIVE CONTROLS**

**1. BANK RATE**

A bank rate is the interest rate of which a nations central bank lends money to domestic banks which in turn impacts economic.

Lower bank rates can help to expand the economy by lowering the cost of funds for barrowers, and higher inflation is higher than desired.

If the bank rate increases by RBI then on other hand commercial banks raise their lending rate. This reduces the money supply in the economy. Reduction in money supply reduces demand for goods and services in the economy resulting in the check on price rise.

**2. OPEN MARKET OPERATIONS**

Open market operations refer to the sale and purchase of securities by the central bank. When the central bank aims to control inflation it sells securities in the open market, thereby reducing reserves of commercial banks. This reduces credit in the market.

**3. VARIATIONS IN RESERVE RECRUITMENT**

Changes in reserve ratio can help combat inflation. The portion of deposits with a commercial bank has statutorily to keep with the central bank s deposit is called the reserve fund.

In order to reduce credit by the commercial banks many a time the central bank increases the percentage of such deposits. Increase in reserve ratio reduces the bank advances, thereby reducing demand for goods and services and checks price rise.

**4. REPO RATE AND REVERSE REPO RATE**

Repo rate is the rate that refers to the rate at which commercial banks borrow money from the reserve bank of India is case of shortage of funds. It is basically used by RBI to keep inflation under control. Reverse repo rate is the rate at which the central bank of a country borrows money from commercial banks with in the country.

**5. LIQUIDITY ADJUSTMENT FACILITY**

It is a tool used in monetary policy that allows bank to barrows money through reo purchase agreements. This arrangement allows banks to respond to liquidity pressures and is used by government to assure basic stability in financial markets.

**2. SELECTIVE / QUALITATIVE CONTROLS**

Selective credit controls are used to encourage or discourage specific types of credit for particular purposes,

**1. CREDTIT RATIONING**

Credit rationing is the limiting by lenders of the supply of additional credit to borrowers by lenders of the supply of additional credit to borrowers who demand funds; it generally provides three things,

(i) An overall ceiling on loans and advances for every commercial bank.
(ii) Fixing the ratio which the capital of a commercial bank should have.
(iii) Fixing ceilings for specific categories of loans and advances.

**2. MARGIN REQUIREMENT**

The difference between the value of security and the amount borrowed against this security is known as margin. The RBI will fix the margin limits for various uses of credit which the commercial banks must observe.

**3. VARIABLE INTEREST RATES**

Variable interest rates charged selectively for different uses places or borrowers can be considered as selective as against a general dear or cheap money policy pursued through changes in the bank.

**4. REGULATION OF CONSUMER CREDIT**

This regulation includes permitting or banning credit for the purchase of certain consumer articles extending or limiting the time for repayment or by lowering or raising the limit of down payment to meet the situation of depressing on recession on the one hand and inflation on the other.

5. **LICENCING**

The RBI ensures proper regional coverage through licensing. Through this incidentally is served the cause of selectivity in regional development.

The present monetary policy which is framed by RBI Governor at AUGUST 2019 is:

| | | |
|---|---|---|
| Bank Rate | --- | 5.65%. |
| Repo Rate | --- | 5.40%. |
| Reverse Repo Rate | --- | 5.15%. |
| Cash Reserve Ratio | --- | 4%. |
| Statuary Liquidity Ratio | --- | 18.5% |

# END

**(17E00308) FINANCIAL INSTITUTIONS AND SERVICES**

**(Elective II)**

**Objective:** The objective of the course is to provide to students an understanding of Financial Markets, the major institutions involved and the services offered within this framework.

1. **Introduction**: The structure of financial system, Elements of financial system and economic development, Regulatory and Promotional Institutions - Function and Role of RBI, Monetary Policy and techniques of RBI,
2. **The Banking and Non-Banking Institutions:** The public and the private sectors – structure and comparative performance, Bank capital and Banking Innovations, Commercial and Co-operative banks. The Non-banking financial Institutions **-** Mutual Funds, Growth of Indian Mutual funds and its Regulation. The Role of AMFI, Insurance Companies- Role of IRDA.
3. **Financial and securities Markets:** Primary and Secondary Markets, Structure and functions of Money Market, -Call call money market, Government Securities Market – T-bills market, Commercial Bills market, Commercial paper and certificate of deposits. Securities markets**:** - Organization and structure, listing trading and settlement of securities market, The role and functions of SEBI
4. **Fund based services** - Lease and hire purchase consumer credit and Factoring - Definition, Functions, Advantages, Evaluation, venture capital financing, Housing Finance.
5. **Fee-based services** - Stock broking, credit rating, Merchant Banking, portfolio services. Underwriting, Depository services, Challenges faced by investment bankers.

**Text Books:**


- Financial Institutions and Markets, L. M. Bhole, 4/e Tata McGraw Hill.
- Financial services, Gorden& Natarajan, Himalaya publishers.


**References:**


- Financial Services and markets, Dr.Punithavathy Pandian, Vikas
- Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
- Indian Financial System, Ramachandra and others, HPH
- Investment Institutions and Markets, Jeff Madura, Cengage, 1st Edition.
- Financial services, Thirpati, PHI.
- Financial Markets &Services, Vasanthdesai, Himalaya.
- Financial Institutions and Markets, Gupta Agarwal, Kalyani publishers.
- Management of Financial Services, C.Rama Gopal ,Vikas.

# UNIT-2

## THE BANIKING AND NON-BANKING INSTITUTIONS

### 1.THE PUBLIC AND PRIVATE SECTORS

- Banking financial institutions are based on service. They create the money or finance. They are the creators of wonderful sculptor of a new economy.
- They create wealth of the nation. They comprise of the commercial banks and co-operative banks.

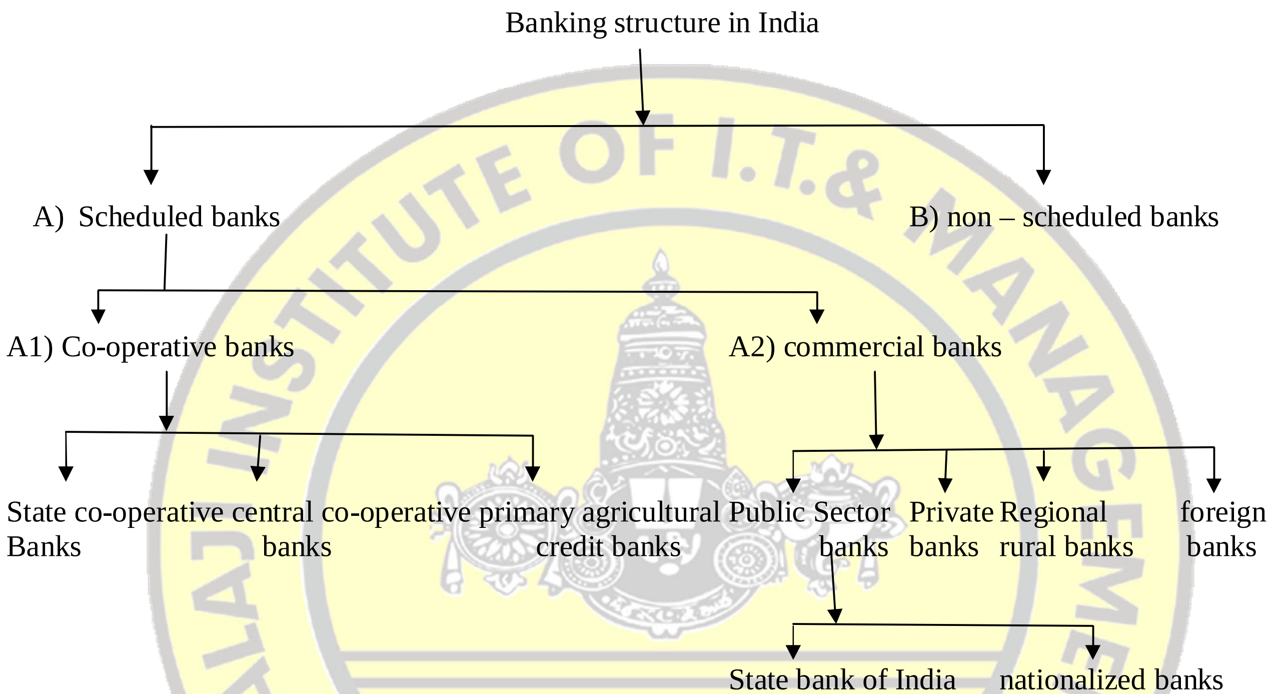
### BANK

- A bank is an institution which deals with money and credit. It accepts deposits from the public make the funds available to those whoneed them and helps in the remittance of money from one place to another.
- According to the Indian banking regulations act 1949, banking means the accepting for the purpose of lending or investment of deposits of money from the public repayable ademand or otherwise and with draw able by cheque, draft or otherwise.

### 1.1 FEATURES OF BANKING

1. The borrowing raising or taking up of money.
2. The lending or advancing of money either with or without security.
3. The granting and issuing of letters of credit, travelers cheques and circular notes.
4. The buying and selling of foreign exchange including bank note.
5. The acquiring, holding, issuing on commission underwriting and dealing in stocks, funds, shares, debentures, bonds, securities, and investment of all kinds.
6. Providing demand drafts.
7. Providing different types of accounts.
8. Facilitating lockers.
9. Giving different types of loans.
10. Facilitating of DeMat accounts, providing insurance.

## 2. BANKING STRUCTURE IN INDIA




### A) SCHEDULED BANKS

- Those banks which area included in the second schedule of the reserve of the reserve bank of India act 1934 are known as scheduled banks.
- These banks should fulfill the following two conditions.

    a. Should have at least 5 lacks as paid-up capital.
    b. Any activity undertakenshould been the interest of the depositors.

### A1) Cooperative banks

Cooperative banks are owned by their customers and follow the cooperative principle of one person, one vote. Co-operative banks are often regulated under both banking and cooperative legislation.

They provide services such as savings and loans to non-members as well as to members and some participate in the wholesale markets for bonds, money and even equities.

Many cooperative banks are traded on public stock markets, with the result that they are partly owned by non-members. Member control is diluted by these outside stakes, so they may be regarded as semi-cooperative.

Cooperative banking systems are also usually more integrated than credit union systems. Local branches of co-operative banks select their own boards of directors and manage their own operations, but most strategic decisions require approval from a central office.

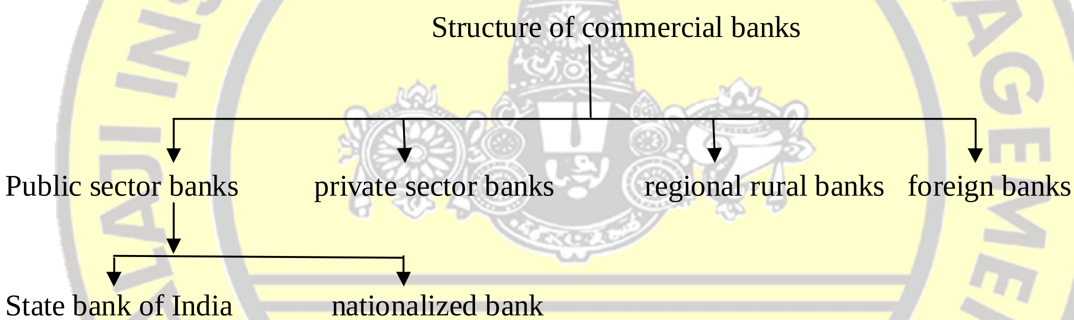
Credit unions usually retain strategic decision-making at a local level, though they share back-office functions, such as access to the global payments system, by federating.

There are three cooperative banks that operate in India

a) State cooperative banks.
b) Central cooperative banks.
c) Primary agriculture banks.

**A2) COMMERCIAL BANKS**

- The banks which perform all kinds of banking business and generally finance, trade and commerce are called commercial banks.
- Commercial banks are also known as joint stock banks,




**PUBLIC SECTOR BANKS**

- ➢ Public sector banks are those which are owned and controlled by the government. In India the nationalized banks and regional rural banks come under this category.

These public sector banks are developed in 4 phases,

- ➢ First the imperial bankof India was nationalized and it was named as the state bank of India in 1955.
- ➢ Letter on 8 former state associated banks were re-constituted into 7subsidieary banks of SBI. These banks are now called associated banks of SBI. Recently these banks are merged with SBI.
- ➢ On 19$^{th}$-july-1969 14 major commercial banks were nationalized. Again on 15-april-1980 6 more commercial banks were nationalized.
- ➢ Another important development in public sector was the establishment of regional rural banks in 1974.

Public sector banks have either the government of India or reserve bank of India as the majority shareholder.

The government/public banks are,

1. Allahabad bank.
2. Andhra bank.
3. Bank of Baroda. -------------------- (Vijaya Bank &Dena Bank Merged into Bank of Baroda)
4. Bank of Maharashtra.
5. Canarabank. ----------------------- (Syndicate Bank Merged into Canara Bank)
6. Central bank of India.
7. Corporation bank.
8. Indian bank. ------------------------ (Allahabad Bank Merged into Indian Bank)
9. Indian overseas bank.
10. Oriental bank of commerce.
11. Bank of India.
12. Punjab and Sind bank.
13. Punjab national bank. ------------- (Oriental bank of commerce & United bank of India Merged into PNB)
14. Syndicate bank.
15. UCO bank.
16. United bank of India.
17. Union bank. ------------------------- (Andhra Bank & Corporation Bank Merged into Union Bank of India)
18. IDBI.
19. State Bank of India.

Recently on 31-Aug-2019 Ministry of Finance announced the merging of banks i.e. Syndicate Bank merged into Canara Bank, Allahabad Bank merged into Indian Bank, Oriental Bank of commerce & United Bank of India are merged into Punjab National Bank, Andhra Bank & Corporation Bank merged into Union Bank of India.

Last year on 2018 Vijaya Bank & Dena Bank are merged into Bank of Baroda.

**PRIVATE SECTOR BANKS**

- These banks are owned by the private individuals or corporations and not by the government or co-operative societies.
- The Narasimhan committee in its first report recommended the freedom of entry into the financial system. It started that the reserve bank of India should permit the establishment ofnew banks in the private sector provided they conform to the minimum start-up capital and other requirements.
- At present there are 20 private sector banks in India,

1. City union bank ltd.
2. Dhanalakshmi bank ltd.
3. Federal bank ltd.
4. catholic Syrian bank ltd.
5. Karnataka bank ltd.
6. Karurvysya bank ltd.
7. Lakshmi vilas bank ltd.
8. Nainital bank ltd.

9. South Indian bank ltd.
10. Tamilnadu mercantile bank ltd.
11. YES bank ltd.
12. Axis bank ltd.
13. Kotak bank ltd.
14. ICICI bank ltd.
15. HDFC bank ltd.
16. IndusInd bank ltd.
17. DCB bank ltd.
18. Bhandan bank ltd.
19. RBL bank ltd.
20. United western bank ltd.

**2.1) FUNCTIONS OF COMMERCIAL BANKS**

The functions of bank are divided into three types,

1. Primary functions.
2. Agency functions.
3. Miscellaneous functions.

**1. PRIMARY FUNCTIONS**

- This can be divided into two kinds' i.e.

a. Deposits
b. Advancing of loans

**A. DEPOSITS**

- Accepting of deposits is the basic function of a bank. They collect surplus money from the public. The depositor's area benefited into two ways.
- At first their amount is 100% safe and they will get interest also on the other hand, the bank can earn a sum of money on the amount mobilized from the public. The higher the amount of deposits the higher the capacity to create credits. The bank has different types of deposits credits. The bank has different types of deposits.

**B. ADVANCING OF LOANS**

The bank can make advances in the form of loans. The loans are sanctioned to the borrowers in different kinds.

Example – overdraft, cash credits, bills disconnecting etc.

**2. PRIMARY FUNCTIONS**

- The banks provide so many functions by discharging their agency functions. The banks act as gents,trustee's attorneys, administrators of their customers.
- The banks will provide the following services to the customers.

a. Buying and selling of shares on behalf of the customers.
b. They collect and pay dues.
c. They act as under writer etc.

**3. MESCELLANEOUS FUNCTIONS**

- These are performed by banks to provide facilities to the customers.
- The following are the examples.
- Locker facility, ATM, online banking, internet backing, issue of traveler's cheque and issue of credit corals.

## 2.2 **PRESENT POSITION**

- At present there are 19 public sectors banks 67RRBs, 25 private sector banks and 45 foreign banks.
- The disadvantages of commercial banks area

1. Insufficient growth.
2. Regional imbalance.
3. Increasingover-dues.
4. Lower efficiency.
5. Declining trends in profitability.
6. Lack of expert.

## 3. BANK CAPITAL

### 3.1 INTRODUCTION

- Bank capital represents the values of a bank's equity instruments that can absorb losses. While bank capital can be defined as the different a bank's assets and liabilities.
- The main banking regulatory frame work consists of international standards enacted by the Basel committee on banking supervision.

### 3.2 BASEL NORMS

- Basel norms area actually a set of norms for the banks aimed at mitigating the risk and strengthening the capital structure of the banks of member countries.
- Basel is a city in Switzerland. It is the need quarters of bureau of international settlement (BIS), which faster's co-operation among central banks of the world.

  BASEL NORMS

  1. Base-1
  2. Base-2
  3. Basae-3

1. **BASEL-1**

- Basel-1 is a set of international banking regulations put forth by the Basel buy the Basel committee on bank supervision (BCBS) that sets out the minimum capital requirements of financial institutions with the goal minimizing credit risk.
- Basel-1 is started in 1988 but in India it is adopted in 1991.
- It is focused almost entirely on credit risk. Minimum capital requirement was fixed at 8% of risk weighted assets(RWA).

2. **BASEL-2**

- Basel-2 is an international business standard that requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.
- Basel-2 accords are a series of recommendations on banking laws and regulations issued by the Basel committee on banking supervision.
- The basel-2 was introduced in 2004, laid down guidelines for capital adequacy, risk management and disclosure requirements.

  The Basel -2 mainly has 3 pillars,

a. Minimum capital requirements
b. Supervisory review
c. Market discipline.

   It was implemented in 2004, but in India it was started in 2009.

**PILLAR-1**

- Minimum capital requirement
- In this pillar it deals with,
  - (i) Credit risk
  - (ii) Operational risk
  - (iii) Mark risk

**PILLAR-2**

- This is a regulatory response of the first pillar, giving regulators better tools over those previously available.
- It also provides a frame for dealing with systemic risk, pension risk, concentration risk, liquidity risk, etc.

**PILLAR-3**

- This pillar aims to complement the minimum capital requirement and supervisory reviews process by developing a set of disclosure requirement which will allow the market participants to gauge the capital adequacy of institutions.
- Market discipline supplements regulations as sharing of information facilitates assessment of the bank by others including investors, analysis, customers, other banks and rating agencies, which leads of good corporate governance.

**BASEL-3**

- Basel-3 is an international regulatory accord that introduced a set of reforms designated of improves the regulations, supervision and risk management with in the banking sector.
- It was introduced in 2010, but India will implement it by 2019/march/31st.

  The main measures of this basel-3 are,

- ➢ Improve the making sectors ability to absorb shocks arising from financial and economic stress.
- ➢ To improve risk management and governance.
- ➢ To strengthen banks transparency and disclosures.

- The governments of India estimates that state run lenders world require 1.8 lakes crores over the next four years.

  For this the government of India launches a scheme called INDHRA DHANUSH according of this the government will infuse 70.000 crores with in four years.

| | | |
|---|---|---|
| 2015-16 | - | 25,000 crores |
| 2016-17 | - | 25,000 crores |
| 2017-18 | - | 10,000 crores |
| 2018-19 | - | 10,000 crores |
| **Total** | **-** | **70,000 crores** |

  The remaining fund should be gathered by bank itself.

  In the recent Budget 2019-20 the government of India has given 70,000 crores to the banks.

## 3.3 CAPITAL ADEQUACY RATIO (CAR)

- CAR is an international standard that measures banks risk of insolvency from excessive losses.
- Currently the minimum acceptable ratio is 8% maintaining an acceptable CAR protects bank depositors and the financial system.
- CAR is also called as CRAR the formula for CAR is,

$$\text{CAR}=\frac{\text{Tier one capital + tier two capital}}{\text{Risk weighted assets}}$$

- Tier one capital is considered the most permanent and readily available support against unexpected losses, includes paid-up capital, statutory reserves, share premium and capital reserves.
- Tier two capital consisting of un disclosed reserves, fully paid-up formularize perpetual preference shares revaluation reserves, general provisions and loss reserves etc.
- It was also prescribing that tier-2 capital should not be more than 100% of tier-1 capital.

## RISK WEIGHTED ASSETS

- It is a risk for banks i.e. the bank gives loans for different people for different purpose. If at all the person cannot fully completes or clear the loan, then the percentage of the loan which is not cleared will be calculated.
- For government bonds the risk weighted assets is 0%.
- For house loan the risk weighted asset will be 50%.
- Like for every loan the risk weighted asset will be calculated.

## 3.4 BANKING INNOVATIONS

More recently the banks in India have introduced a number of innovations and diversifications in their operations to improve their performance.

### 3.5 Need of Financial Innovations

Taxes, regulation, irrelevance information, transaction costs, and moral hazard exist in the real world making the market imperfect. This affects the financial instruments and makes them obsolete as the new requirements arise. Without Financial innovations new financial process and products will not emerge in the market. These imperfections prevent participants in the economy from efficiently obtaining the functions they need from the financial system. To remove all these imperfections, Indian Banking system has taken some innovative activities and function.

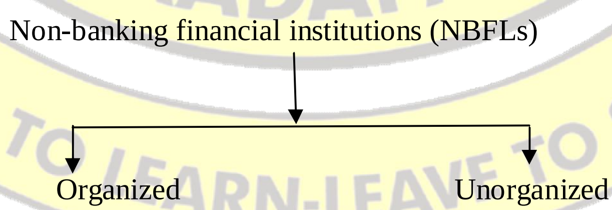
- Adopting participatory approach.
- Introducing credit card facility.
- Introducing new technology and computerization in lending operations.
- Paying more attention to sophistication better consumer service and great profitability.
- Internet banking.
- Mobile banking etc.
- Mutual Banking.
- Factoring.
- Venture Capital.
- Microfinance.
- Anywhere Banking.
- Islamic Banking.
- Electronic Banking.

With all these, banks are giving satisfactory and disciplined service to the customers. The Indian Banking system is passing through a phase of customer's market presently.

With stiff competition and advancement of technology, the services provided by banks have become more easy and convenient. With reformation and innovation, the Indian Banking deals with the latest discovery in the banking instruments along with the polished version of their old systems.

## 4.NON-BANKING FINANCIAL INSTITUTIONS

- A part from the above banking financial institutions a lot of capital market activities are performed by the other financial institutions which are non-banking in nature.
- They achieve participate in capital transformation process from savers to investors in economy. They collect funds by accepting deposits from individuals and lend them to trade industries government etc. They buy and sell instruments and also create new instruments as per different needs of the savers.




## 4.1 TYPES OF NBFIs IN INDIA

Broadly NBFIs in India are classified into two groups i.e. organized and unorganized.

## 4.2 ORGANISED NBFIs

- The organized NBFIs include development banks and other specialized institutions.

- Development banks are those financial institutions which perform twin functions of providing medium and long-term loans of the private entrepreneurs and of performing various promotional roles conductive to economic development.
- Development banks are further divided into industrial development banks such as IDBI, ICICI, SIDBIetc and agricultural development banks such as NABARD, and development hanks. Some more NBFLs operating in the organized sector are LIC, GIC and UTI etc.

**4.3 UNORGANISED NBFIs**

A number of un-organized NBFIs also operating in the country. They are known as loan company's hire-purchase companies, chit funds, nidhis etc.

The following are the list of all India financial institutions,

- Industrial development bank ofIndia(IDBI).
- Industrial Finance Corporation of India (IFCI).
- Export-import bank of India (EXIM).
- Industrial reconstruction bank of India (IRBI).
- National bank for agriculture and rural development(NABARD).
- Small industries development bank of India (SIDBI).
- National housing bank(NHB).
- Unit trust of India (UTI).
- Life insurance Corporation of India(LIC).
- General Insurance Corporation of India(GIC).
- Risk capital and technology finance corporation ltd (RCTC).
- Tourism finance corporation of India(TFCI).
- Power finance corporation ltd.
- Indian railways finance corporation ltd.

**4.4 THE MAIN FUNCTIONS OF NBFIs are**

1. **FINANCIAL INTERMEDIATION**
   The main function of the financial institutions is the transfer of funds from the savers to the investors.
2. **INVESTMENT OF FUNDS**
   The main objectives of NBFIs are toearn profits by investing the mobilizing savings. For this purpose, they will invest in different companies or different investment policies.
3. **ECONOMIC BASIS OF FINANCIAL INTERMEDIATION**
   Handling of funds by financial intermediaries ismore economical and more efficient than that by the individual wealth owners because of the fact that financial intermediation is based on,LAW OF LARGE NUMBERSAccording to this law if there are a large number of people related to the NBFIs then that company will get a large amounts of money fractions and companies will lend or invert the amount in different sectors or portfolios.

## 5.MUTUAL FUNDS

- A mutual fund collects the savings from small investors, invest them in government and other corporate securities and earn income through interest and dividends besides capital gains.
- It works on the principle of small drops of water make a big ocean.
- For instance, if one has Rs.1000 to invest it may not fetchvery much on its own. But when it is pooled with Rs.1000 each from a lot of other people the one could Crete a big fund large enough to invest in wide varieties of shares and debentures.
- Hence a mutual fund is nothing but a form of collective investment.
- Kit is formed by the coming together of a number ofinvestors who transfer their surplus funds toa professionally qualified organization to manage it.
- Each investor is allocated with units in proportion to the sizeof his investment.

## 5.1 TYPES OF MUTUAL FUNDS

TYPES OF MUTUAL FUNDS

On the basis of execution & operations

Close –ended

Open- ended

on the basis of yield & investment pattern

Income fund

Growth fund

Balanced fund

Specialized fund

Money market fund

Taxation fund

On the basis of execution and operation

1. **CLOSE-ENDED FUND**

- Under this scheme the corpus of the fund and its duration are prefixed. In other words, the corpus of the fund and the number of units are determined in advance.
- Once the subscription reaches the pre-determined the entry of inventors is closed.
- Customer should wait up to the maturity period to get the amount what he has invested.

2. **OPEN-ENDED FUND**

- It is just opposite of close-ended funds. Under this scheme the size of the funds and the period of the fundsare not pre-determined.

- The investment is free to buy and sell any number of units at any point of time. For instance, the unit scheme of the UTI is an open ended one, both in terms of period and target amounts.
- Anybody can buy this unit at any time and sell it at any time at his interest.

**ON THE BASIS OF YIELD AND INVESTMENT PATTERN**

1. **INCOME FUND**

- As the very name suggests, this fund aims at generating and distributing regular income to the members on a periodical basis.
- It concentrates more on the distribution of regular income and it's also seen that the average return is higher than that of the income farm bank deposits.

2. **GROWTH ARIENTED FUNDS**

- Unlike the income funds growth funds concentrate mainly on long-run gains, capital appreciation.
- They do not offer regular income and they aim at capital appreciation in the long-run. Hence they have been described as nest eggs investment.

3. **BALANCED FUNDS**

- This is other wises called income cum-growth fund
- It is nothing but a combination of both income and growth funds. It aims at distributing regular income as well as capital appreciation.
- This is achieved by balancing the investments between the high growth equity shares and also the fixed income earning securities.

4. **SPECIALISED FUNDS**

- Besides the above, a large number of specialized funds are in existence abroad. They offer special schemes so as to meet the specific needs of specific categories of people like pensioners, windows etc.
- There are funds for investments in securities of specified areas. In fact, these funs open the door for foreign investors to invest on the domestic securities of these countries.

5. **MONEY-MARKET MUTUAL FUNDS**

- These funds are basically open ended funds and as such they have all the features of the open ended fund. But, theyinvest in highly liquid and safe securities like commercial paper, certificates of deposits, treasures bills etc.
- These instruments are called money market instruments.

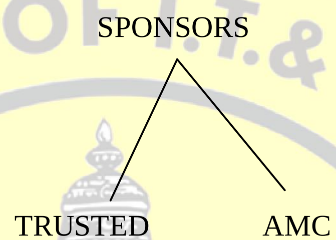
6. **TAXATION FUNDS**

- A taxation fund is basically a growth oriented fund. But it offers tax rebates to the investors either in the domestic or foreign capital market.
- It is suitable to salaried people who want to enjoy tax rebates particularly during the month of February and March.

## 5.2 ORGANISATION OF THE MUTUAL FUND

The structure mutual fund operations in India assumes a three tier establishment namely,

(i) A sponsor institution to promote the fund
(ii) A teamof trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund
(iii) An asset management company (AMC) to actually deal with funds.




**A. SPONSORS/SPONSORING INSTITUTION**

- The company which sets-up the mutual fund is called the sponsor.
- The SEBI has laid down certain criteria to be met by the sponsor.
- These criteria mainly deal with adequate experience and good track record.

**B. TRUSTEES**

- Trustees are people with long experience and good integrity in their respective fields.
- They carry the crucial responsibility of safe guarding the interest of investors.
- For this purpose, thy monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss asset management companies with the approval of the SEBI

**C. ASSET MANAGEMENT COMPANY(AMC)**

- The AMC actually manages the funds of the various schemes.
- The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing.
- The success of any usual fund depends upon the efficiency of this AMC.
- This AMC submits a quarterly report on the functioning of the mutual fund to the trusted that will guide and control the AMC.

## 5.3 OPERATION OF THE MUTUAL FUND

- A mutual fund invites the investors to join the mutual fund schema by offering various schemes that suits for different investors.
- The resources of individual investors are pooled (gathered) together and the investor area issued by shared/units for the money invested.
- For managing this fund a mutual fund gets an annual fee of 1.25% funds managed as the maximum as fixed by the SEBI regulations 1993and if fund exceed Rs.100 crores , it is only 1%. It cannot be taken more than that.

### 5.4 Role of AMFI

- AMC are also under an organization called the AMFI, which is a body that has been created to promote the interests of the mutual funds like CII is there for Indian industries or NASSCOM for the IT industries.
- They define the standards for the mutual funds working
- They frame the code of conduct and promote best business practices.
- To interact with SEBI for all related matters with the mutual funds.
- To represent the mutual fund industry in front of the government, RBI and other bodies which have a link with the mutual fund industry.

### 5.6 THE ADVANTAGES OF INVESTING IN MUTUAL FUNDS

**A. PROFESSIONAL MANAGEMENT**

In mutual funds there will be experienced and skilled professionals who are backed by a dedicated investment research team who analyze the performance companies and selects suitable investments to achieve the objects of the scheme.

**B. DIVERSIFICATION**

- Mutual funds invest in a number of companies across a broad cross-section of industries and sectors.
- This diversification reduces the risk because if one company gets loses the other company or sector will increase them the risk on the investment will definitely reduce and investor will get good returns.

**C. CONVENIENT ADMINISTARATION**

- Investing in mutual fund reduces paperwork helps you to avoid many problems such as bad deliveries delayed payments and unnecessary follow up with broker.

**D. RETURN POTENTIAL**

Over a medium to long-term mutual funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

**E. LOW COSTS**

- Mutual funds are a relatively less expensive way to invest when compared to invest directly in the capital markets.
- The risk in choosing the companies where to invest and what area the technical analysis of the company's shares such problems will be calculated by fund angers in mutual funds.

**F. LIQUIDITY**

- In open-ended schemes you can get your net asset value (money) at any time.
- In closed-ended schemes there will be some period (maturity date) after completing the data one can get their amount easily to their bank accounts.

**G. TRANSPARENCY**

You will get regular information on the value of your investment through e-mails or SMS etc.

**H. WELL REGULATED**

All mutual funds are registered with SEBI and they function within the strict regulations designed and monitored by SEBI and AMFC (association of mutual funds companies.)

## 6. INDIAN INSURANCE INDUSTRY

- Insurance may be described as a social device to reduce or eliminate risk of life and property. Under the plan of insurance, a large number of people associated themselves by sharing risk attached to individual.
- Insurance is actually a contract between two parties where by one partycalled insurer undertakes in exchange for a fixed sum called premium to pay the other party happening of an event.

**OR**

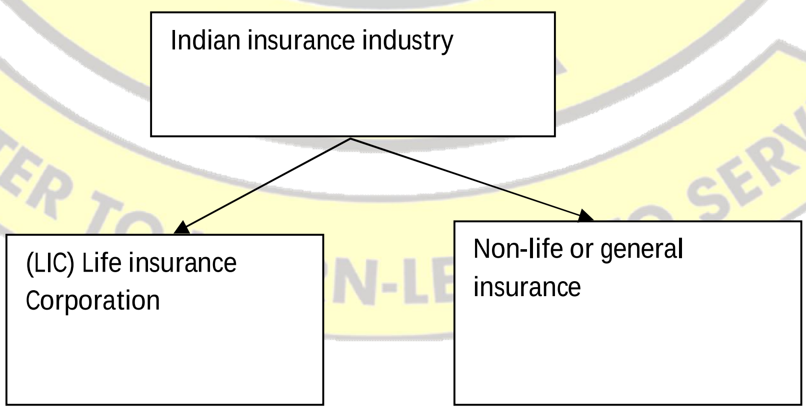
- It is a legal contract between two parties whereby one party called insurer undertakes to pay a fixed amount of money on the happening of a particular event which may be certain or uncertain. The other party called ensured pays in exchange a fixed sum known as premium.
- The document which embodies the contract is called the policy.

## 6.2 HISTORY OF INSURANCE SECTORS

- The business of life insurance in India starts in the year 1818 with the establishment of the oriental life insurance company in Calcutta (it is started by Europeans)
- In 1850 the first general insurance company was started in Calcutta by British.
- In 1870 Bombay mutual life assurance society becomes the first Indian insurer.
- In the year 1912 the life insurance company's act and the provident fund act were passed to regulate the insurance business.
- In 1956 a list of 245 Indian and foreign companies are merged in to one i.e. LIC.

The Indian insurance industry is divided into two distinct markets.

1. LIC
2. Non-life or general insurance market.



## LIFE INSURANCE CORPORATION

- The life insurance corporation business in India was started back form 1818
- In 1956 the life insurance business of all companies are merged together and forms as a single company that is life insurance Corporation of India.

## OBJECTIVES OF LIC

The objectives of LIC are,

1. To spread life insurance and provide life insurance protection to the masses at reasonable cost.
2. To mobilize people savings throughinsurance linked savings schemes.
3. To act as trustees of the policy holders and protect their individual and collective interest.
4. To provide financial assistance to boost the industrial growth.
5. To conduct business with maximum economy always remembering that the money belongs to the policy holders.

## FUNCTIONS OF LIC

The main functions of LIC are,

1. **TO MOBILSE SAVINGS.**
   The LIC mobilizes the public savings and makes them available to industrial uses for both public and private sectors.
2. **DEPLOYMENT OF FUNDS IN MONEY MARKET INSTRUMENS**
   The funds which are collected are temporarily deployed in short term moneymarket instruments like call/notice money, certificates deposits, government treasury bills and commercial papers issued by corporate.
3. **INVESTMENT IN SMALL AND MEDIUM SCALE INDUSTRIES**
   The LIC indirectly helps small scale and medium scale industries by subscribing to the shares and bonds of state financial corporations.
4. **RESOURCES SUPPORT TO FINANCIAL INSTITUTIONS.**

- LIC also assists the industrial corporate sector indirectly by extending resources support to various financial institutions (SFCs, IFCI) by way of tem loans.
- The only public sector company that is under life insurance business is LIC.
  There are so many private sector life insurance companies,
  Example,
  1. Bajaj Allianz life insurance.
  2. Tata AIG life.
  3. Birla sun life insurance.
  4. SBI life.
  5. Max New York life.
  6. Kotak life insurance.
  7. HDFC standard life insurance company limited.
  8. Reliance life.
  9. Aviva life insurance Company limited.
  10. ICICI prudential life insurance company limited.

**GENERAL INSURANCE**

- It is having a history back to the 1850 where the first general insurance company was established in Calcutta by BritishIndia.
- In 1972 the general insurance business was nationalized by the government of India.
- There are only 4 public general insurance companies that are,

1. National insurance company ltd.
2. New India assurance company ltd.
3. Oriental insurance company ltd.
4. United India insurance company ltd.

There are so many private sector companies in general insurance in India for example,

1. ICICI Lombard general insurance, company ltd.
2. TATA AIG general insurance company ltd.
3. IFFCO TOKYO general insurance.
4. Reliance general insurance company ltd.
5. Choromandalam MS general insurance company ltd.
6. HDFC ERGO general insurance.
7. Royal sundaram LLIANCE-insurance company ltd.
8. Bharati AXA general insurance company.
9. Sriram general insurance company ltd.

**6.4 TYPES OF INSURANCE**

**1) MOTOR INSURANCE**

- This includes automobile truck, motorcycle, aircraft, boat or any other form of motorized transportation.
- It is perhaps the most common type of insurance and covers the financial loss for insurer.

**2) HEALTH INSURANCE**

- Most of the countries are moving with this health insurance in some countries the government-funded health care, which means that most of all citizens have access to medical facilities and treatment with minimum amount of policies.
- Now-a-days there are a different types of health insurance like different body parts will get different health according to that the insurer will go far that policy.

**3)DISABILITY INSURANCE**

- This form of insurance protects workers from injuries and illness which prevent them from doing their jobs.

- Workers compensations are common in the US and pay a worker his wages and medical expenses in the event of an injury on the job.
- Permanent disability which prevents a worker from ever working again is covered by total permanent disability insurance. This provides the disabled employee with benefits for the rest of his/her life.

4) **PROPERTY INSURANCE**
Type of insurance typically covers things like homes, machinery, crops, valuable goods, shipped cargo, rented property and more.

5) **CREDIT INSURANCE**
This is taken by lenders who need coverage against the people that have credit with them(borrow money). In the event of their inability to pay off back (usually due to disability or death) this type of insurance policy will protect the lender

## 6.5 ROLE OF IRDA

Functions of IRDA:

The functions of the IRDAI are defined in Section 14 of the IRDAI Act, 1999, and include:

- Issuing, renewing, modifying, withdrawing, suspending or cancelling registrations.
- Protecting policyholder interests.
- Specifying qualifications, the code of conduct and training for intermediaries and agents.
- Specifying the code of conduct for surveyors and loss assessors.
- Promoting efficiency in the conduct of insurance businesses.
- Promoting and regulating professional organizations connected with the insurance and re-insurance industry.
- Levying fees and other charges.
- Inspecting and investigating insurers, intermediaries and other relevant organizations.
- Regulating rates, advantages, terms and conditions which may be offered by insurers not covered by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938).
- Specifying how books should be kept.
- Regulating company investment of funds.
- Regulating a margin of solvency.
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries.
- Supervising the Tariff Advisory Committee.
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organizations.
- Specifying the percentage of life- and general-insurance business undertaken in the rural or social sector.
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries.

**END**

**(17E00308) FINANCIAL INSTITUTIONS AND SERVICES**

**(Elective II)**

**Objective:** The objective of the course is to provide to students an understanding of Financial Markets, the major institutions involved and the services offered within this framework.

1. **Introduction**: The structure of financial system, Elements of financial system and economic development, Regulatory and Promotional Institutions - Function and Role of RBI, Monetary Policy and techniques of RBI,
2. **The Banking and Non-Banking Institutions:** The public and the private sectors – structure and comparative performance, Bank capital and Banking Innovations, Commercial and Co-operative banks. The Non-banking financial Institutions **-** Mutual Funds, Growth of Indian Mutual funds and its Regulation. The Role of AMFI, Insurance Companies- Role of IRDA.
3. **Financial and securities Markets:** Primary and Secondary Markets, Structure and functions of Money Market, -Call call money market, Government Securities Market – T-bills market, Commercial Bills market, Commercial paper and certificate of deposits. Securitiesmarkets**:** - Organization and structure, listing trading and settlement of securities market, The role and functions of SEBI
4. **Fund based services** - Lease and hire purchase consumer credit and Factoring - Definition, Functions, Advantages, Evaluation, venture capital financing, Housing Finance.
5. **Fee-based services** - Stock broking, credit rating, Merchant Banking, portfolio services. Underwriting, Depository services, Challenges faced by investment bankers.

**Text Books:**


- Financial Institutions and Markets, L. M. Bhole, 4/e Tata McGraw Hill.
- Financial services, Gorden& Natarajan, Himalaya publishers.


**References:**


- Financial Services and markets, Dr.Punithavathy Pandian, Vikas
- Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
- Indian Financial System, Ramachandra and others, HPH
- Investment Institutions and Markets, Jeff Madura, Cengage, 1st Edition.
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- Financial Markets &Services, Vasanthdesai, Himalaya.
- Financial Institutions and Markets, Gupta Agarwal, Kalyani publishers.
- Management of Financial Services ,C.Rama Gopal ,Vikas.
- Management of Financial Services ,C.Rama Gopal ,Vikas.

# UNIT-3

## FINANCIAL AND SECURITY MARKETS

### 1.INTRODUCTION:

A **financial market** is a market in which people trade financial securities, commodities, and value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds, and commodities include precious metals or agricultural products.

In economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them.

Structure of financial market

It is divided into four types

1) Capital market.
2) Money market.
3) Derivative market.
4) Foreign exchange market.

1.1 A **capital market** is a financial market in which long-term debt or equity-backed securities are bought and sold. Capital markets are defined as markets in which money is provided for period longer than a year.

Capital market consist of: stock markets and bond markets Stock, which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof. Bond, which provide financing through the issuance of bonds, and enable the subsequent trading thereof.

Capital market is consisting of **primary markets and secondary markets.**

**1.2 Money market** is a market which deals with short term funds in the economy. In money market, the funds can be borrowed for a short period varying from a day, a week, a month or 3 to 6 months against different types of securities or instruments.

There are several money market instruments, including treasury bills, commercial paper, bankers' acceptances, deposits, certificates of deposit, bills of exchange, repurchase agreements, federal funds, and short-lived mortgage- and asset-backed securities. The instruments bear differing maturities, currencies, credit risks, and structure and thus may be used to distribute exposure.

1.3 The **derivatives market** is the financial market for derivatives, financial instruments like futures contracts or options, which are derived from other forms of assets.

1.4 The **foreign exchange market** (**Forex**, **FX**, or **currency market**) is a global decentralized or over-the-counter (OTC) market for the trading of currencies. This market determines the foreign exchange rate. It includes all aspects of buying, selling and exchanging currencies at current or determined prices.

## 2.SECURITIES MARKET

**Securities market** is a component of the wider financial market where securities can be bought and sold between subjects of the economy, on the basis of demand and supply. Securities markets encompasses equity markets, bond markets and derivatives markets where prices can be determined and participants both professional and non-professionals can meet.

Securities markets can be split into below two levels. Primary markets, where new securities are issued and secondary markets where existing securities can be bought and sold. Secondary markets can further be split into organised exchanges, such stock exchanges and over-the-counter where individual parties come together and buy or sell securities directly.

In secondary market the securities may be sold and converted into cash increases the willingness of people to hold stocks and bonds and thus increases the ability of firms to issue securities.

1) Primary market or New Issue market.

2) Stock Exchange or Secondary Market.

## 2.1PRIMARY MARKET

The **primary market** is the part of the capital market that deals with issuing of new securities. Primary markets create long term instruments through which corporate entities raise funds from the capital market.

Types of issues in primary market.

1) Public issue.
2) Rights issue.
3) Preferential allotment.
4) Private placement.

In a primary market, companies, governments or public sector institutions can raise funds through bond issues and corporations can raise capital through the sale of new stockthrough an initial public offering (IPO). This is often done through an investment bank or finance syndicate of securities dealers. The process of selling new shares to investors is called underwriting.

The main features of primary markets are:

- This is the market for new long term equity capital. The primary market is the market where the securities are sold for the first time. Therefore, it is also called the new issue market (NIM).
- In a primary issue, the securities are issued by the company directly to investors.
- The company receives the money and issues new security certificates to the investors.
- Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.
- The primary market performs the crucial function of facilitating capital formation in the economy.

### 2.1.2 FUNCTIONS OF PRIMARY MARKET

1) The key function of the primary market is to facilitate capital growth by enabling individuals to convert savings into investments. It facilitates companies to issue new stocks to raise money directly from households for business expansion or to meet financial obligations. It provides a channel for the government to raise funds from the public to finance public sector projects.

2) Underwriting is the process by which investment bankers raise investment capital from investors on behalf of corporations and governments that are issuing either equity or debt securities. The word "underwriter" originally came from the practice of having each risk-taker write his name under the total amount of risk he was willing to accept at a specified premium. This centuries-old practice continues, in a way, as new issues are usually brought to market by an underwriting syndicate, in which each firm takes the responsibility, as well as the risk, of selling its specific allotment.

### 2.1.3 TYPES OF ISSUES IN PRIMARY MARKET:

1. **Public issue:** Securities are issued to the all the members of the public who are eligible to participate in the issue
2. **Private placement:** The sale of securities to a relatively small number of select investors as a way of raising capital. This is a wholesale issue of securities to institutional investors by an unlisted company
3. **Preferential issue:** A private placement of securities by a listed company. Securities are issued to an identified set of investors which may include promoters, strategic investors, employees and groups.
4. **Qualified Institutional Placement (QIP):** A private placement of securities by a listed company to a set of institutional investors termed as qualified institutional buyers is a QIP.
5. **Rights and bonus issues:** Securities are issued to existing investors by offering them to buy more securities at a pre-determined price (rights) or get an allotment of additional free shares bonus).

### 2.1.3.1 PUBLIC ISSUE:

Initial public offering (IPO) is one type of public offering. Not all public offerings are IPOs. An IPO occurs only when a company offers its shares (no other securities) for the first time for public ownership and trading.

However, public offerings are also made by already-listed companies. The company issues additional securities to the public, adding to those currently being traded. For example, a listed company with 8 million shares outstanding can offer to the public another 2 million shares. This is a public offering but not an IPO. Once the transaction is complete, the company will have 10 million shares outstanding.

Advantages:

- Enlarging and diversifying equity base.
- Increases the wealth of the company.
- Generate public awareness.
- Enabling cheaper access to capital
- Increasing exposure, prestige, and public image
- Attracting and retaining better management and employees through liquid equity participation
- Facilitating acquisitions (potentially in return for shares of stock)
- Creating multiple financing opportunities: equity, convertible debt, cheaper bank loans, etc.

Dis advantages:

- Significant legal, accounting and marketing costs, many of which are ongoing
- Requirement to disclose financial and business information
- Meaningful time, effort and attention required of management
- Risk that required funding will not be raised
- Public dissemination of information which may be useful to competitors, suppliers and customers.
- Loss of control and stronger agency problems due to new shareholders
- Increased risk of litigation, including private securities class actions and shareholder derivative actions.
-

### 2.1.3.2 RIGHT ISSUES:

A rights issue is a dividend of subscription rights to buy additional securities in a company made to the company's existing security holders. Rights issues are typically sold via a prospectus or prospectus supplement. With the rights issued, existing security-holders have the privilege to buy a specified number of new securities from the issuer at a specified price within a subscription period. In a public company, a rights issue is a form of public offering (different from most other types of public offering, where shares are issued to the general public).

(A rights issue is a dividend of subscription rights to buy additional securities in a company made to the company's existing security holders. When the rights are for equity securities, such as shares, in a public company, it is a non-dilutive pro rata way to raise capital.)

Advantages:

- It is cheaper than a public share issue
- It is made at the discretion of the directors, without consent of the shareholders or the Stock Exchange.
- It rarely fails
- Existing shareholders' equity stakes are not diluted, provided they take up their rights.

Disadvantages:

- There is a limit to how much can be raised through this method as existing shareholders are only willing to invest so much. A rough rule of thumb is that a rights issue could raise up to 25% of the existing equity value of the firm.
- If shareholders do not take up their rights, then their shareholding will be diluted.

**2.1.3.3 Qualified institutional placement**:

- (**QIP**) is a capital-raising tool, primarily used in India and other parts of southern Asia, whereby a listed company can issue equity shares, fully and partly convertible debentures, or any securities other than warrants which are convertible to equity shares to a qualified institutional buyer (QIB).
- Apart from preferential allotment, this is the only other speedy method of private placement whereby a listed company can issue shares or convertible securities to a select group of persons. QIP scores over other methods because the issuing firm does not have to undergo elaborate procedural requirements to raise this capital.
- Advantages:
- **Time saving:**
- QIBs can be raised within short span of time rather than in FPO, Right Issue takes long process.

- **Rules and regulations:**
  In a QIP there are fewer formalities with regard to rules and regulation, as compared to follow-on public issue (FPO) and rights Issue.
  A QIP would mean that a company would only have to pay incremental fees to the exchange. Additionally in the case of a GDR, you would have to convert your accounts to IFRS (International Financial Reporting Standards). For a QIP, company’s audited results are more than enough.

- **Cost-efficient:**
  The cost differential vis-à-vis an ADR/GDR or FCCB in terms of legal fees, is huge. Then there is the entire process of listing overseas, the fees involved. It is easier to be listed on the BSE/NSE vis-à-vis seeking a say Luxembourg or a Singapore listing.
- **Lock-in:**
  It provides an opportunity to buy non-locking shares and as such is an easy mechanism if corporate governance and other required parameters are in place.

2.1.3.5 Preferential shares or allotment

**Preferred stock** (also called **preferred shares**, **preference shares** or simply **preferred**) is a type of stock which may have any combination of features not possessed by common stock including properties of both an equity and a debt instrument, and is generally considered a hybrid instrument.

Preferred stocks are senior (i.e., higher ranking) to common stock, but subordinate to bonds in terms of claim (or rights to their share of the assets of the company) and may have priority over common stock (ordinary shares) in the payment of dividends and upon liquidation.

Advantages:

- One advantage of raising money via a this is that it helps save costs and time involved in public issue.
- There is no requirement of filling any offer document /notice to SEBI in case of the preferential allotment.
- In this the shares are allotted in bulk without incurring much cost.
- Interested members can apply for shares in a lots for simple prices.

2.1.3.6 RIGTHS AND BOND ISSUES:

A rights offering (issue) is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price. Rights are often transferable, allowing the holder to sell them on the open market.

Advantages:

- It is cheaper than a public share issue
- It is made at the discretion of the directors, without consent of the shareholders or the Stock Exchange.
- It rarely fails
- Existing shareholders' equity stakes are not diluted, provided they take up their rights.

Disvantages:

- Here is a limit to how much can be raised through this method as existing shareholders are only willing to invest so much. A rough rule of thumb is that a rights issue could rise up to 25% of the existing equity value of the firm.
- If shareholders do not take up their rights, then their shareholding will be diluted.

## 2.2 SECONDARY MARKET

The **secondary market**, also called the aftermarket, is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold. ... After the initial issuance, investors can purchase from other investors in the secondary market.

Intermediaries in secondary market:

- Stock Brokers
- Financial Intermediaries.
- Individual Investors.

### 2.2.1 STOCK BROKERS:

A stock broker is a qualified and regulated professional who buys and sells shares and other securities through markets makers on behalf of investors. These brokers also give knowledge to their high net worth individuals, clients for managing their finance well and investing in portfolio for considerable wealth creation.

### 2.2.2 FINANCIAL INTERMEDIARIES:

Financial intermediaries as a player in secondary market include all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers.

Financial intermediaries accept funds from one entity and lend these funds to another entity. There are various financial intermediaries which help in pooling funds from savers and provide the same to the borrowers. They are as follows

a) Commercial banks.
b) Financial institutions.
c) Insurance company’s.
d) Mutual fund.
e) Non-banking financial institutions.

### 2.2.3 INDIVIDUAL INVESTORS:

Individual investors make implicit forecasts or assumptions about these factors without elaborate reports because they have no need to communicate beyond the purchase or sale order to their brokers. The individual need not prepare any formal studies because a simple one-line note may serve to preserve the basis of a decision for future reference.

### 2.2.4 Features of secondary market:

1) Ensure Liquidity of Capital
2) The securities once listed continue to be traded at the exchanges.
3) Safety in dealing
4) Helpful in raising new capital.
5) Platform for public debt.
6) Clearing house of business information.
7) Mobilizing surplus savings.

### 2.2.5 Functions of secondary market:

*1. Economic Barometer:*

A stock exchange is a reliable barometer to measure the economic condition of a country. Every major change in country and economy is reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. Stock exchange is also known as a pulse of economy or economic mirror which reflects the economic conditions of a country.

*2. Pricing of Securities:*

The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The valuation of securities is useful for investors, government and creditors. The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.

*3. Safety of Transactions:*

In stock market only the listed securities are traded and stock exchange authorities include the companies' names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

*4. Contributes to Economic Growth:*

In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

*5. Spreading of Equity Cult:*

Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

*6. Providing Scope for Speculation:*

To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

*7. Liquidity:*

The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.

*8. Better Allocation of Capital:*

The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor's fund to profitable channels.

*9. Promotes the Habits of Savings and Investment:*

The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

# 3.CALL MONEY

Call money is money loaned by a bank that must be repaid on demand. Unlike a term loan, which has a set maturity and payment schedule, call money does not have to follow a fixed schedule, nor does the lender have to provide any notice of repayment. Brokerages use call money as a short-term source of funding to maintain margin accounts for the benefit of their customers who wish to leverage their investments. The funds can move quickly between lenders and brokerage firms.

# 4. GOVERNMENT SECURITY MARKET:

A government security is a bond issued by a government authority with a promise of repayment upon maturity. Government securities such as savings bonds, treasury bills and notes also promise periodic coupon or interest payments. These securities are considered low-risk, since they are backed by the taxing power of the government.

## 5.STRUCTURE AND FUNCTIONS OF MONEY MARKET

Money market is a sub-sector of the fixed income market. Money market instruments sometimes are called cash equipment or just cash for short. It consists of very short-term debt securities that are highly marketable. Money market instruments include short-term marketable liquid, low-risk debt securities. The various money market instruments are as follows,

Money market instruments

- TREASURY BILLS (T-BILLS).
- CERTIFICATE OF DEPOSITS (CDs).
- BANKERS ACCEPTANCE.
- EURO DOLLARS.
- REPOS AND REVERSES.
- FEDERAL FUNDS.
- BROKER'S CALLS.
- THE LIBOR MARKET.

- **TREASURY BILLS (T-BILLS)**

T-bills or just bills, for short are the most marketable money market instrument. T-bills represent the simplest form of borrowing. The government raises money by selling billsto the public. Investors buy the bills at a discount from the stated maturity value. At the time of bills maturity the holder receives from the government a payment equal to the face value of the bill. The difference between the purchase price and ultimate maturity value constitutes the investor's earnings.

T-bills are issued with an initial maturity period of 28, 91 or 182days. Individuals can purchase these bills directly or at auction or on the secondary market from a government securities dealer. The income earned on T-bills is exempt from tax.

- **CERTIFICATE OF DEPOSITS (CDs)**

It is a time deposit with a bank. Time deposits may not be withdrawn on demand. The bank pays interest ad principles to the depositor only at the end of the fixed term of the CD.

- **BANKERS ACCEPTANCE**

A banker's acceptance starts as an order to a bank by bank's customer to pay a sum of money at a future date, typically within 6 months. At this stage it is similar to post-dated cheque. When the bank endorses the order for payment as accepted, it assumes responsibility for ultimate payment to the holder of the acceptance. At this point the acceptance may be traded in secondary market.

- **EURO DOLLARS**

Euro dollars denominated deposits at foreign banks or foreign branches of America banks. By locating outside the US, these banks escape regulation by the Federal Reserve. Despite the tag Euro these accounts need not be in European banks, although that is where the practice of accepting dollar-denominated deposits outside the US began.

Most of the Eurodollar deposits are for large sums, and time deposits of less than 6 months' maturity. A variation on the Eurodollar time deposit is the Eurodollar certificate of deposit. A Eurodollar CD resembles a domestic bank CD except that it is the liability of a non-US branch of a bank typically a London branch.

The advantage of Eurodollar CDs over Eurodollar time deposits is that the holder can sell the asset realizing its cash value before maturity.

- **REPOS AND REVERSES**

Dealers in government securities use repurchase agreements also called repos (RPs) as a form of short-term usually overnight borrowing. The dealer sells government securities to an investor on an overnight basis, with an agreement to buy back those securities the next day at a slightly higher price.

The increase in the price is the overnight interest. The dealer thus takes out a 1-day loan from the investor, and the securities serve as collateral.

A reverse repo is the mirror of a repo. Here, the dealer finds an investor holding government securities and buys them agreeing to sell them back at a specified higher price on a future data.

- **FEDERAL FUNDS**

Just as most of us maintain deposits at banks, banks maintain deposits of their own at a federal reserve bank of the fed, is required to maintain a minimum balance in the reserve account with the fed. The required balance depends on the total deposits of the bank's reserve account are called federal funds.

- **BROKER'S CALLS**

Individuals who buy stocks on margin borrow part of the funds to pay for the stocks from their broker. The broker in turn may borrow the funds from a bank, agreeing to repay the bank immediately (on call) if the bank requests it.

- **THE LIBOR MARKET**

The London Interbank Offered Rate (LIBOR) is the rate at which large banks in London are willing to lend money among themselves. This rate which is quoted on dollar-denominated loans has become the premier short-term interest rate quoted in the European money market and it serves as a reference rate for a wide range of transaction.

## 6.SECURITY MARKET

Security market is a component of the wider financial market where securities can be bought and sold between subjects of the economy, on the basis of demand and supply. Securities markets encompasses equity markets, bond markets and derivatives markets where prices can be determined and participants both professional and non-professionals can meet.

## 7.STRUCTURE OF SECURITY MARKET

Securities markets can be split into below two levels. **Primary markets**, where new securities are issued and secondary markets where existing securities can be bought and sold. **Secondary markets** can further be split into organised exchanges, such stock exchanges and over-the-counter where individual parties come together and buy or sell securities directly.

For securities holders knowing that a secondary market exists in which their securities may be sold and converted into cash increases the willingness of people to hold stocks and bonds and thus increases the ability of firms to issue securities.

**SECURITY MARKET**

PRIMARY MARKET SECONDARY MARKET

# 8. LISTING TRADING AND SETTLEMENT OF SECURITIES

Before selling the securities through stock exchange, the companies have to get their securities listed in the stock exchange. The name of the company is included in listed securities only when stock exchange authorities are satisfied with the financial soundness and other aspects of the company.

Previously the buying and selling of securities was done in trading floor of stock exchange; today it is executed through computer and it involves the following steps:

## 1. *Selection of a broker:*

The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator.

## 2. *Opening Demat Account with Depository:*

Demat (Dematerialized) account refer to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (e.g. Shares, Debentures, Bonds, Mutual (Funds, etc.) At present in India there are two depositories: NSDL (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.) There is no direct contact between depository and investor. Depository interacts with investors through depository participants only.

Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

## 3. *Placing the Order:*

After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.

Investor must place the order very clearly specifying the range of price at which securities can be bought or sold. e.g. “Buy 100 equity shares of Reliance for not more than Rs 500 per share.”

## 4. *Executing the Order:*

As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

### 5. Settlement:

This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There can be two types of settlement.

### (a) On the spot settlement:

It means settlement is done immediately and on spot settlement follows. T + 2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday.

### (b) Forward settlement:

It means settlement will take place on some future date. It can be T + 5 or T + 7, etc. All trading in stock exchanges takes place between 9.55 am and 3.30 pm. Monday to Friday.

## 8.1TYPES OF ORDER:

An **order** is an instruction to buy or sell on a trading venue such as a stock market, bond market, commodity market, or financial derivative market. These instructions can be simple or complicated, and can be sent to either a broker or directly to a trading venue via direct market access.

### 1) Market order -

A **market order** is a buy or sell order to be executed immediately at current *market* prices. As long as there are willing sellers and buyers, market orders are filled. Market orders are therefore used when certainty of execution is a priority over price of execution.

A market order is the simplest of the order types. This order type does not allow any control over the price received. The order is filled at the best price available at the relevant time. In fast-moving markets, the price paid or received may be quite different from the last price quoted before the order was entered.

### 2) Limit order –

A **limit order** is an order to buy a security at no more than a specific price, or to sell a security at no less than a specific price (called "or better" for either direction). This gives the trader (customer) control over the price at which the trade is executed; however, the order may never be executed ("filled"). Limit orders are used when the trader wishes to control price rather than certainty of execution.

A buy limit order can only be executed at the limit price or lower. For example, if an investor wants to buy a stock, but doesn't want to pay more than $20 for it, the investor can place a limit order to buy the stock at $20. By entering a limit order rather than a market order, the investor will not buy the stock at a higher price, but, may get fewer shares than he wants or not get the stock at all.

A sell limit order is analogous; it can only be executed at the limit price or higher.

Both buy and sell orders can be additionally constrained. Two of the most common additional constraints are fill or kill (FOK) and all or none (AON). FOK orders are either filled completely on the first attempt or cancelled outright, while AON orders stipulate that the order must be filled with the entire number of shares specified, or not filled at all. If it is not filled, it is still held on the order book for later execution.

### 3) Day order-

A day order or good for day order (GFD) (the most common) is a market or limit order that is in force from the time the order is submitted to the end of the day's trading session.

### 4) Good-Till-Cancelled –

(GTC) orders require a specific cancelling order, which can persist indefinitely (although brokers may set some limits. It is also called as open order.

### 5) Immediate or cancel –

(IOC) orders are immediately executed or cancelled by the exchange.

### 6) Fill-or-Kill –

Fill or kill (FOK) orders are usually limit orders that must be executed or cancelled immediately. Unlike IOC orders, FOK orders require the full quantity to be executed.

### 7) Stop loss order-

A stop order, also referred to as a stop-loss order, is an order to buy or sell a stock once the price of the stock reaches a specified price, known as the stop price. When the stop price is reached, a stop order becomes a market order. A buy–stop order is entered at a stop price above the current market price.

Investors generally use a buy stop order to limit a loss or to protect a profit on a stock that they have sold short. A sell–stop order is entered at a stop price below the current market price. Investors generally use a sell–stop order to limit a loss or to protect a profit on a stock that they own.

### 8) Sell stop order –

A **sell–stop order** is an instruction to sell at the best available price after the price goes below the stop price. A sell–stop price is always below the current market price. For example, if an investor holds a stock currently valued at $50 and is worried that the value may drop, he/she can place a sell–stop order at $40. If the share price drops to $40, the broker sells the stock at the next available price. This can limit the investor's losses or lock in some of the investor's profits (if the stop price is at or above the purchase price).

### *9)* Buy–stop order-

A buy–stop order is typically used to limit a loss (or to protect an existing profit) on a short sale.[12] A buy-stop price is always above the current market price. For example, if an investor sells a stock short—hoping for the stock price to go down so they can return the borrowed shares at a lower price (i.e., covering)—the investor may use a buy stop order to protect against lossesif the price goes too high. It can also be used to advantage ina declining market when you want to enter a long position close to the bottom after turnaround.

### 10) Stop limit order-

A **stop–limit order** combines the features of a stop order and a limit order. A stop-limit order is an order to buy or sell a stock that combines the features of a stop order and a limit order. Once the stop price is reached, a stop-limit order becomes a limit order that will be executed at a specified price (or better). As with all limit orders, a stop–limit order doesn't get filled if the security's price never reaches the specified limit price.

## 8.2 CONTRACT NOTE IN TRADING:

Contract note is the legal record of any transaction carried out on a stock exchange through a stock broker. It serves as the confirmation of trade done on a particular day on behalf of a client on a stock exchange (BSE/NSE). You receive this document from your broker at end of day if you have bought or sold share through him. This document is also available in digitally signed electronic format.

Contract note describes key details of a particular transaction together with date, time, price, quantity traded etc. It also includes a Reference Number which can be used to cross-check the details of the transaction with the stock exchanges. A valid contract note should have following details in structured format

- SEBI registration number of the Trading Member/ Sub broker.
- Details of trade like, Order Number, Trade Number., Trade Price, Trade execution Time, Traded Quantity, Brokerage Charged, Settlement Reference Number, Details of other Service Charges.
- Signature of Authorized Signatory or Digital Signature in Electronic format.
- Bylaws and regulations pertaining to Arbitration.

### Delivery instruction slip (DIS) for shares sold:

Once the investor receive the contract note he is expected to make payment of shares that he purchased, within the next day of trading (known as T+1 day, T stands for “Trading day “).

The broker will be collecting this amount from the customer and remitting to the exchange the next day, known as T+2 days.

If the investor had sold the shares, he should give delivery of shares to his broker, so that these can be remitted to the exchange the next day and payment received for the same day. hence, these shares have to be taken out of the demat account of investors, for which delivery instruction slip (DIS) is required to be given to the broker by the investor by T+1 days.

## Receiving shares or Funds on T+2 day:

In India, settlement is completed in T+2 days. All who purchased shares on T day (trading day), would be receiving the shares in their demat account two days later.

### Procedure of settlement of securities in secondary markets:

National Securities Clearing Corporation Limited, NSCCL, a wholly owned subsidiary of NSE is responsible for clearing and settlement of all trades executed on NSE and deposit and collateral management and risk management functions. NSCCL was the first clearing corporation to be established in India and we introduced settlement guarantee before it became a regulatory requirement. NSCCL has maintained a credit rating of "AAA" from CRISIL since 2008.

**Objectives**

- To bring and sustain confidence in clearing and settlement of securities;
- To promote and maintain, short and consistent settlement cycles;
- To provide counter-party risk guarantee, and
- To operate a tight risk containment system.

## 8.3 **Listing of securities:**

Listing means the admission of securities of a company to trading on a stock exchange. Listing is not compulsory under the Companies Act 2013/1956. It becomes necessary when a Public Limited Company wants to issue shares or debentures to the public. When securities are listed on a stock exchange, the company has to comply with the requirements of the exchange.

The listing provides an exclusive privilege to securities on the stock exchange. Only listed shares are quoted on the stock exchange. Stock exchange provides transparency in transactions of listed securities and equality and competitive conditions. Listing is beneficial for the company, to the investor, and to the public at large.

### Objectives of listing

- To provide liquidity to securities
- To provide a mechanism for effective control and supervision of trading

- To mobilize savings for economic development
- To provide free negotiability to stocks.
- Ability to raise further capital

## Eligibility criteria in BSE.

1. Applicant Company, desirous of getting listed should comply with the required Eligibility criteria as prescribed by the stock exchange.

   **Minimum Listing Requirements for New Companies**

- The minimum post-issue paid-up capital of the company shall be INR. 10 Crore for IPOs.
- The minimum issue size shall be INR. 10 crores.
- The minimum market capitalization of the Company shall be INR. 25 crores.
- In addition to above eligibility criteria, certain conditions prescribed under SEBI, ICDR (Issue of Capital & Disclosure Requirements) Regulations, 2009.
- The issuer shall comply all the applicable guidance, regulations interlaid from SEBISecurities Contracts (Regulations) Act 1956.
- And any other circular, clarifications, guidelines issued by the appropriate authority.

2. Permission to Use the Name of BSE Listing Process in Issuer Company's Prospectus

   Companies have to take prior approval from BSE to use the name of BSE in their prospectus or offer for sale documents before filing the same with the concerned office of the Registrar of Companies.

3. Submission of Letter of Application

   A Letter of Application need to be submitted to all the stock exchanges where they want to get it listed before filing to the application.

4. Allotment of Securities

   As per the Listing Agreement, a company is required to complete the allotment of securities within 30 days of the date of closure of the subscription list to the public.

5. Trading Permission

   After the completion of allotment, within 7 working days, the issuer Company has to complete the formalities for trading at all the stock exchanges, where the securities are to be listed.

6. Requirement of 1% Security

Companies have to deposit 1% of the issue amount with the designated stock exchange before the issue opens.

7. Listing Fees

   All listed companies are required to pay to BSE, an Annual Listing Fees by 30th April of every financial year

8. Compliance with the Listing Agreement

   When companies get listed at stock exchanges, whether it is BSE/ NSE Listing Process they are required to enter into an agreement which is called the listing Agreement under which they are required to file certain compliances and disclosures which are given by listing Agreement, failing which the company may face some disciplinary action, including suspension/delisting of securities. Under listing agreements, all the terms and conditions are written on the basis of which the company has to perform like

- provide facilities for direct transfer, registration, sub-division, and consolidation of securities.
- send proper notices of the closure of transfer books and record dates, forward 6 copies of Annual Reports, Balance Sheets and Profit and Loss Accounts to BSE/NSE.
- to file shareholding patterns and financial results on a quarterly basis;
- to intimate Exchange, the happenings which are likely to materially affect the financial performance of the Company and its stock prices,
- to comply with the conditions of Corporate Governance, etc.

The benefits of listing on **NSE** are as enumerated below:

- NSE provides a trading platform that extends across the length and breadth of the country. Listing on NSE thus, enables issuers to reach and service investors across the country.

- NSE being the largest stock exchange in terms of trading volumes, the securities trade at low impact cost and are highly liquid. This in turn reduces the cost of trading to the investor.

- The trading system of NSE provides unparalleled level of trade and post-trade information. The best 5 buy and sell orders are displayed on the trading system and the total number of securities available for buying and selling is also displayed. This helps the investor to know the depth of the market. Further, corporate announcements, results, corporate actions etc. are also available on the trading system, thus reducing scope for price manipulation or misuse.

- The facility of making initial public offers (IPOs), using NSE's network and software, results in significant reduction in cost and time of issues.

- NSE's web-site www.nseindia.com provides a link to the web-sites of the companies that are listed on NSE, so that visitors interested in any company can visit that company's web-site from the NSE site.
- Listed companies are provided with monthly trade statistics of the securities of the company listed on the Exchange.
- The listing fee is nominal.

## 9.THE ROLE AND FUNCTIONS OF SEBI

The **Securities and Exchange Board of India** (**SEBI**) is the regulator for the securities market in India. It was established in 1988 and given statutory powers on 30 January 1992 through the SEBI Act, 1992.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental there to".

SEBI has to be responsive to the needs of three groups, which constitute the market:

- Issuers of securities.
- Investors.
- Market intermediaries.

SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member tribunal and is headed by Justice J P Devadhar, of the Bombay High Court. A second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

### 9.1 FUNCTIONS OF SEBI

1)Regulating the business in stock exchanges and any other securities markets.

2) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner registering and regulating the working of the depositories, [participants], custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;]

3) Registering and regulating the working of [venture capital funds and collective investment schemes], including mutual funds;

4) Promoting and regulating self-regulatory organisations;

5) Prohibiting fraudulent and unfair trade practices relating to securities markets;

6) Promoting investors ‘education and training of intermediaries of securities markets;

7) Prohibiting insider trading in securities;

8) Regulating substantial acquisition of shares and takeover of companies;

9)calling for information from, undertaking inspection, conducting inquiries and audits of the [stock exchanges, mutual funds, other persons associated with the securities market], intermediaries and self-regulatory organisations in the securities market;

**(17E00308) FINANCIAL INSTITUTIONS AND SERVICES**

**(Elective II)**

**Objective:** The objective of the course is to provide to students an understanding of Financial Markets, the major institutions involved and the services offered within this framework.

1. **Introduction**: The structure of financial system, Elements of financial system and economic development, Regulatory and Promotional Institutions - Function and Role of RBI, Monetary Policy and techniques of RBI,
2. **The Banking and Non-Banking Institutions:** The public and the private sectors – structure and comparative performance, Bank capital and Banking Innovations, Commercial and Co-operative banks. The Non-banking financial Institutions **-** Mutual Funds, Growth of Indian Mutual funds and its Regulation. The Role of AMFI, Insurance Companies- Role of IRDA.
3. **Financial and securities Markets:** Primary and Secondary Markets, Structure and functions of Money Market, -Call call money market, Government Securities Market – T-bills market, Commercial Bills market, Commercial paper and certificate of deposits. Securitiesmarkets**:** - Organization and structure, listing trading and settlement of securities market, The role and functions of SEBI
4. **Fund based services** - Lease and hire purchase consumer credit and Factoring - Definition, Functions, Advantages, Evaluation, venture capital financing, Housing Finance.
5. **Fee-based services** - Stock broking, credit rating, Merchant Banking, portfolio services. Underwriting, Depository services, Challenges faced by investment bankers.

**Text Books:**


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**References:**


- Financial Services and markets, Dr.Punithavathy Pandian, Vikas
- Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
- Indian Financial System, Ramachandra and others, HPH
- Investment Institutions and Markets, Jeff Madura, Cengage, 1st Edition.
- Financial services, Thirpati, PHI.
- Financial Markets &Services, Vasanthdesai, Himalaya.
- Financial Institutions and Markets, Gupta Agarwal, Kalyani publishers.
- Management of Financial Services ,C.Rama Gopal ,Vikas.

# UNIT-4

# FUND BASED SERVICES

## 1.Introduction

Fund based financial services (FBFS) are financing method that is driven by the assets of companies. Assets include current assets, such as accounts receivables and inventory and fixed assets such as plant and machinery.

Types of fund based services

1) Lease financing.
2) Hire purchase.
3) Consumer credit/consumer finance
4) Factoring.
5) Venture capital financing.
6) Housing finance.

## 2.LEASE

A lease is a contract outlining the terms under which one party agrees to rent property owned by another party. It guarantees the lessee, the tenant, use of an asset and guarantees the lessor, the property owner or landlord, regular payments from the lessee for a specified number of months or years. Both the lessee and the lessor face consequences if they fail to uphold the terms of the contract.

A lease is a legal contract, and thus enforceable by all parties under the contract law of the applicable jurisdiction.

Common elements of a lease agreement include:

- Names of the parties of the agreement.
- The starting date and duration of the agreement.
- Identifies the specific object (by street address, VIN, or make/model, serial number) being leased.
- Provides conditions for renewal or non-renewal.
- Has a specific consideration (a lump sum or periodic payments) for granting the use of this object.
- Have provisions for a security deposit and terms for its return.
- May have a specific list of conditions which are therein described as Default Conditions and specific Remedies.

May have other specific conditions placed upon the parties such as:

- Need to provide insurance for loss.
- Restrictive use.

- Which party is responsible for maintenance.

Termination clause (describing what will happen if the contract is ended early or cancelled, stating the rights of parties to terminate the lease, and their obligations)

All kinds of personal property (e.g. cars and furniture) or real property (e.g. raw land, apartments, single family homes, and business property (including wholesale and retail)) may be leased. As a result of the lease, the owner (lessor) grants the use of the stated property to the lessee.

**LESSEE:**

The user or renter of the leased asset or property is called lessee. when real estate is leased the lessee is called a tenant.

Following are the types of lessee-

1) Corporate customer with high credit rating.
2) Public sector undertaking.
3) Mid-market companies.
4) Consumers.
5) Car customers.
6) Commercial vehicles.
7) Earth moving machinery customers. Etc.

**LESSOR:**

Owner or the title holder of the leased asset or property, in case of leveraged leases, however a third party (the Leander) and not the lessor hold the title.

Following are the types of lessor-

1) Specialised leasing companies.
2) Banks and bank subsidiaries.
3) Specialized financial instructions.
4) Manufacture lessors. Etc.

TYPES OF LEASE:

The following are the types of lease-

1) Operating or service lease.
2) Financial lease.
3) Sale and lease back.
4) Direct lease.
5) Single investor lease.
6) Leveraged lease.
7) Domestic lease.
8) International lease.

1) **Operating Lease:**

Contrary to capital lease, the period of operating lease is shorter and it is often cancellable at the option of lessee with prior notice. Hence, operating lease is also called as an ‘Open end Lease Arrangement.’ The lease term is shorter than the economic life of the asset. Thus, the lessor does not recover its investment during the first lease period. Some of the examples of operating lease are leasing of copying machines, certain computer hardware, world processors, automobiles, etc.

There is some criticism too labelled against capital leasing and operating leasing. Let us give the arguments given by the proponents and opponents regarding the two types of equipment leasing. It is argued that a firm knowing about the possible obsolescence of high technology equipment may not want to purchase any equipment. Instead, it will prefer to go for operating lease to avoid the possible risk of obsolescence. There is one difference between an operating lease and capital/financial lease.

Operating lease is short-term and cancellable by the lessee. It is also called as an ‘Open end Lease Agreement’. In case of a financial lease, the risk of equipment obsolescence is shifted to the lessee rather than on the lessor.

The reason is that it is a long-term and non-cancellable agreement or contract. Hence, lessee is required to make rental payments even after obsolescence of equipment. On the other hand, it is said that in operating lease, the risk of loss shifts from lessee to lessor.

This reasoning is not correct because if the lessor is concerned about the possible obsolescence, he will certainly compensate for this risk by charging higher lease rentals. As a matter of fact, it is more or less a ‘war of wits’ only.

Examples –providing mobile cranes with operators.

-Hiring of computers with operators.

2) **Capital /financial Lease:**

This is also called ‘financial lease’. A capital lease is a long-term arrangement which is non-cancellable. The lessee is obligated to pay lease rent till the expiry of lease period. The period of lease agreement generally corresponds to the useful life of the asset concern.

A long-term lease in which the lessee must record the leased item as an asset on his/her balance sheet and record the present value of the lease payments as debt. Additionally, the lessor must record the lease as a sale on his/her own balance sheet. A capital lease may last for several years and is not canceable. It is treated as a sale for tax purposes.

**3. Sale and Leaseback:**

It is a sub-part of finance lease. Under a sale and leaseback arrangement, a firm sells an asset to another party who in turn leases it back to the firm. The asset is usually sold at the market value on the day. The firm, thus, receives the sales price in cash, on the one hand, and economic use of the asset sold, on the other.

Yes, the firm is obliged to make periodic rental payments to the lessor. Sale and leaseback arrangement is beneficial for both lessor and lessee. While the former gets tax benefits due to depreciation, the latter has immediate cash inflow which improves his liquidity position.

In fact, such arrangement is popular with companies facing short-term liquidity crisis. However, under this arrangement, the assets are not physically exchanged but it all happens in records only.

This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected to depreciation but appreciation, say for example, land.

**4. Leveraged Leasing:**

A special form of leasing has become very popular in recent years. This is known as Leveraged Leasing. This is popular in the financing of “big-tickets” assets such as aircraft, oil rigs and railway equipment's. In contrast to earlier mentioned three types of leasing, three parties are involved in case of leveraged lease arrangement – Lessee, Lessor and the lender.

Leveraged leasing can be defined as a lease arrangement in which the lessor provides an equity portion (say 25%) of the leased asset's cost and the third-party lenders provide the balance of the financing. The lessor, the owner of the asset is entitled to depreciation allowance associated with the asset.

5) Direct lease:

A **lease** arrangement between a non-manufacturer or non-dealer and a customer wherein the lessor acquires equipment for the purpose of leasing it and generating revenue through interest payments. The lessor is often a financial institution that uses this arrangement as an alternative to a direct loan.

6) Single investor lease:

In single investor lease, there are two parties – lessor and lessee. The lessor arranges the money to finance the asset or equipment by way of equity or debt. The lender is entitled to recover money from the lessor only and not from the lessee in case of default by a lessor. Lessee is entitled to pay the lease rentals only to the lessor.

7) Leveraged lease:

Leveraged lease, on the other hand, has three parties – lessor, lessee and the financier or lender. Equity is arranged by the lessor and debt is financed by the lender or financier. Here, there is a direct connection of the lender with the lessee and in a case of default by the lessor; the lender is also entitled to receive money from the lessee. Such transactions are generally routed through a trustee.

8) International lease:

The International lease is of two types – Import Lease and Cross Border Lease.

When lessor and lessee reside in the same country and equipment supplier stays in the different country, the lease arrangement is called import lease.

When the lessor and lessee are residing in two different countries and no matter where the equipment supplier stays, the lease is called cross-border lease.

**ADVANTAGES----**

Leasing brings six major advantages, and all directly involve the company's cash flow. Essentially, the advantage to leasing over buying is that there's usually no large outlay of cash at the beginning of the lease as there is with an outright purchase.

- **100 percent financing:** Many business leases come with 100 percent financing terms, which means no money changes hands at the inception of the lease. Can you imagine what a boon to cash flow this can be?

  Well, it's not totally cash-free, because the lessee has to make the lease payments each month. But many times the assumption is that the company will be making the payments from future cash flows — in other words, from enhanced revenues that the company earns because of the lease.

- **Obsolescence:** Another advantage to leasing is working around obsolescence, which means the company anticipates frequently replacing the fixed asset. For example, many larger clients lease rather than purchase their computer equipment so they can stay current with new and faster computer processing technology.

- **Flexibility:** Asset flexibility is another leasing advantage. Based on the relationship between the lessor and the lessee, the lease may be for either just a few months or the entire expected life of the asset. Or let's say an employee for whom the company leases a vehicle leaves the company.

  Predicated on the terms of the lease, the company doesn't have to worry about advertising the car for sale and trying to find a buyer, as it would with an owned vehicle — the company just turns the car back in to the leasing company.

- **Lower-cost financing:** Based on many different variables, a company may be able to utilize tax benefits associated with leasing. This topic is a more complicated tax issue that is more appropriate for your taxation classes.

- **Tax advantages:** Separate from any tax benefit a company may gain, lease payments can reduce taxable income in a more appropriate manner than depreciation expense. Remember that you treat operating leases like rentals by expensing the entire lease payment when the business makes it.

- **Off-balance-sheet financing:** Finally, operating leases provide off-the-books (or balance sheet) financing. In other words, the company's obligation to pay the lease, which is a liability, doesn't reflect on the balance sheet. This can affect a financial statement user's evaluation of how solvent the company is because he will be unaware of the debt—hence the importance of footnotes to financial statements.

**Disadvantages**

Following are some of the key disadvantages of leasing.

- Leasing has a rate of interest embedded in the required lease rentals. For example, Company ABC has an option to purchase the car at invoice price of $50,000 or lease it out against 6 annual payments or $12,000. In short, the lease rentals do not only include contribution towards the use of asset, they also include a finance cost.
- In a leasing arrangement, the lessee does not own the asset during and after the lease term which means that he can't sell or transfer or pledge it. However, some leases might include a clause entitling the lessee to purchase the asset at the end of the lease term against a payment.
- The lessee is liable to bear the maintenance cost of the leased asset during the term of the lease even if he does not own it in the end.

## 2.HIRE PURCHASE

A **hire purchase** (British English; abbreviated **HP**) or an **Instalment plan** (American English) is an arrangement whereby a customer acquires an asset by paying an initial instalment (e.g. 40% of the total) and repays the other part of the cost of the asset over a period of time or term for a contract, in which a purchaser agrees to pay for goods in parts or a percentage over a number of months. Other analogous practices are described as closed-end leasing or rent to own.

The hire purchase agreement was developed in the United Kingdom in the 19th century.

If the buyer defaults in paying the instalments, the owner may repossess the goods, a vendor protection not available with unsecured-consumer-credit systems. HP is frequently advantageous to consumers because it spreads the cost of expensive items over an extended time period. Business consumers may find the different balance sheet and taxation treatment of hire-purchased goods beneficial to their taxable income. The need for HP is reduced when consumers have collateral or other forms of credit readily available.

Following are the features of a regular hire purchase transaction:

- Rental payments are paid in instalments over the period of the agreement.
- Each rental payment is considered as a charge for hiring the asset. This means that, if the hirer defaults on any payment, the seller has all the rights to take back the assets.
- All the required terms and conditions between both the parties involved are documented in a contract called Hire-Purchase agreement.
- The frequency of the instalments may be annual, half-yearly, quarterly, monthly, etc. according to the terms of the agreement.
- Assets are instantly delivered to the hirer as soon as the agreement is signed.

- If the hirer uses the option to purchase, the assets are passed to him after the last instalment is paid.
- If the hirer does not want to own the asset, he can return the assets any time and is not required to pay any instalments that fall due after the return.
- However, once the hirer returns the assets, he cannot claim back any payments already paid as they are the charges towards the hire and use of the assets.
- The hirer cannot pledge, sell or mortgage the assets as he is not the owner of the assets till the last payment is made.
- The hirer, usually, pays a certain amount as an initial deposit while signing the agreement.
- Generally, the hirer can terminate the hire purchase agreement any time before the ownership rights pass to him.

HOW THE TRANSACTION / PROCESS OF HIRE PURCHASE TAKES PLACE STEP BY STEP?


TYPES OF HIRE PURCHASE –

1) Consumer instalment credit.
2) Industrial commercial credit.

**Consumer instalment credit-**

Consumer credit is a debt that a person incurs when purchasing a good or service. Consumer credit includes purchases obtained with credit cards, lines of credit and some loans. Consumer credit is also known as consumer debt. Consumer credit is divided into two classifications: revolving credit and instalment credit. The most common form of consumer credit is a credit card.

**Industrial and commercial credit –**

A commercial and industrial (C&I) loan is any type of loan made to a business or corporation and not to an individual. Commercial and industrial loans can be made in order to provide either working capital or to finance major capital expenditures. This type of loan is usually short-term in nature and is almost always backed with some sort of collateral.

**3.Consumer Credit**

Consumer credit is a debt that a person incurs when purchasing a good or service. Consumer credit includes purchases obtained with credit cards, lines of credit and some loans. Consumer credit is also known as consumer debt. Consumer credit is divided into two classifications: revolving credit and instalments credit. The most common form of consumer credit is a credit card.

Economists and other financial analysts frequently measure consumer credit, which serves as an indicator of economic growth. For example, if consumers can easily borrow money and repay those debts on time, then the economy is stimulated resulting in economic growth.

Consumer credit is the portion of credit consumers use to buy non-investment services consumed or goods that depreciate quickly. This includes automobiles, education costs, recreational vehicles (RVs), boat and trailer loans, but it does not include debts obtained to purchase margin on investment accounts or real estate. For example, a mortgage loan is not consumer credit. However, the 65-inch high-definition television charged on a credit card is consumer credit.

Consumer credit allows consumers to get an advance or loan to spend money on products or services for family, household or personal uses repaid at a specified future date. Retailers, department stores, banks and other financial institutions offer consumer credit.

**Types of Consumer Credit**

1) **INSTALMENT CRDIT.**
2) **REVOLVING CREDIT.**

**Instalment credit** is used for a specific purpose, for a defined amount and for a specific period. Payments are usually the same amount each month. Examples of purchases made on instalment credit include large appliances, automobiles and furniture. These kinds of loans usually offer lower interest rates than revolving credit. For example, a car company holds a lien on the car until the car loan is repaid. The total amount of the principal and interest is repaid within a predefined period. If the customer defaults on the loan payments, the company can repossess the car and charge penalties.

**Revolving credit** can be utilized for any purpose. Loans are made on a continuous basis for purchases until the consumer reaches his credit limit. Customers receive bills periodically to make at least a minimum monthly payment. For example, Visa can approve a consumer for a $5,000 credit card limit with a 13% interest rate. If the consumer defaults on payments, the credit card company can charge late fees or other penalties.

**4.FACTORING**:

**Factoring** is a transaction in which a business sells its invoices, or receivables, to a third-party financial company known as a “factor.” The factor then collects payment on those invoices from the business's customers. Factoring is known in some industries as “accounts receivable financing.”

Most factoring companies purchase invoices in two instalments. The first instalment – the factoring advance – covers about 80% of the receivable (this amount varies). The remaining 20%, less the factoring fee, is rebated as soon as your client pays the invoice in full.

Factoring reduces your bookkeeping costs and your overhead expenses. Factoring allows you to make cash payments to your suppliers, which means you can take advantage of discounts and reduce your production costs. Factoring makes it possible for a business to finance its operations from its own receivables.

Different types of factoring—

1. Full Factoring.

2. Recourse Factoring.

3. Maturity Factoring.

4. Advance Factoring.

5. Undisclosed Factoring.

6. Invoice Discounting.

7. Bulk Factoring.

8. Agency Factoring.

**1. Full Factoring**

This is also known as "Without Recourse Factoring ". It is the most comprehensive type of facility offering all types of services namely finance sales ledger administration, collection, debt protection and customer information.

**2. Recourse Factoring**

The Factoring provides all types of facilities except debt protection. This type of service is offered in India. As discussed earlier, under Recourse Factoring, the client's liability to Factor is not discharged until the customer pays in full.

**3. Maturity Factoring**

It is also known as "Collection Factoring ". Under this arrangement, except providing finance, all other basic characteristics of Factoring are present. The payment is effected to the client at the end of collection period or the day of collecting accounts whichever is earlier.

**4. Advance Factoring**

This could be with or without recourse. Under this arrangement, the Factor provides advance at an agreed rate of interest to the client on uncollected and non-due receivables. This is only a pre-payment and not an advance.

Under this method, the customer is not notified about the arrangement between the client and the Factor. Hence the buyer is unaware of factoring arrangement. Debt collection is organized by the client who makes payment of each invoice to the Factor, if advance payment had been received earlier.

**6. Invoice Discounting**

In this arrangement, the only facility provided by the Factor is finance. In this method the client is a reputed company who would like to deal with its customers directly, including collection, and keep this Factoring arrangement confidential.

The client collects payments from customer and hands it over to Factor. The risk involved in invoice discounting is much higher than in any other methods.

The Factor has liberty to convert the facility by notifying all the clients to protect his interest. This service is becoming quite popular in Europe and nearly one third of Factoring business comprises this facility.

**7. Bulk Factoring**

It is a modified version of Involve discounting wherein notification of assignment of debts is given to the customers. However, the client is subject to full recourse and he carries out his own administration and collection.

**8. Agency Factoring**

Under this arrangement, the facilities of finance and protection against bad debts are provided by the Factor whereas the sales ledger administration and collection of debts are carried out by the client.

**Cost of factoring** –

The cost of factoring includes the following:

1) **Finance charge**:
Finance charge is computed on the prepayment outstanding in the clients account at monthly intervals. These charges are similar to the interest levied on the cash credit facilities in a bank.
2) **Service fee**:
Service charges is a nominal charge levied at monthly intervals to cover the most of service such as collection, sales ledger management and periodical MIS reports.

**Steps in factoring**:

1) Customer places an order with the client for goods or services on credit, client delivers the goods and sends invoice to customers.
2) Client assigns invoice to factor.
3) Factor makes prepayment up to 80% and sends periodical statements.
4) Monthly statement of accounts to customers and follow up.
5) Customer makes payment to factor.
6) Factor makes balance 20% of payment on realization to the client.

ADVANTAGES:

- It can be a cost-effective way of outsourcing your sales ledger while freeing up your time to manage the business.
- It assists smoother cash flow and financial planning.
- Some customers may respect factors and pay more quickly.
- Factors may give you useful information about the credit standing of your customers and they can help you to negotiate better terms with your suppliers.
- Factors can prove an excellent strategic - as well as financial - resource when planning business growth.
- You will be protected from bad debts if you choose non-recourse factoring.
- Cash is released as soon as orders are invoiced and is available for capital investment and funding of your next orders.
- Factors will credit check your customers and can help your business trade with better quality customers.

# 5.VENTURE CAPITAL

Venture capital is financing that investors provide to start-up companies and small businesses that are believed to have long-term growth potential.

Venture capital generally comes from well-off investors, investment banks and any other financial institutions. However, it does not always take just a monetary form; it can be provided in the form of technical or managerial expertise.

Though it can be risky for the investors who put up the funds, the potential for above-average returns is an attractive payoff. For new companies or ventures that have a limited operating history (under two years), venture capital funding is increasingly becoming a popular – even essential – source for raising capital, especially if they lack access to capital markets, bank loans or other debt instruments. The main downside is that the investors usually get equity in the company, and thus a say in company decisions.

**The Venture Capital Process**

The first step for any business looking for venture capital is to submit a business plan, either to a venture capital firm or to an angel investor. If interested in the proposal, the firm or the investor must then perform due diligence or evaluation, which includes a thorough investigation of the company's business model, products, management and operating history, among other things.

Since venture capital tends to invest larger dollar amounts in fewer companies, this background research is very important. Many venture capital professionals have had prior investment experience, often as equity research analysts; others have Masters in Business Administration (MBA) degrees. Venture capital professionals also tend to concentrate in a particular industry. A venture capitalist that specializes in healthcare, for example, may have had prior experience as a healthcare industry analyst.

Once due diligence has been completed, the firm or the investor will pledge an investment of capital in exchange for equity in the company. These funds may be provided all at once, but more typically the capital is provided in rounds. The firm or investor then takes an active role in the funded company, advising and monitoring its progress before releasing additional funds.

The investor exits the company after a period of time, typically four to six years after the initial investment, by initiating a merger, acquisition or initial public offering (IPO).

ADVANTAGES:

- It injects long term equity finance which provides a solid capital base for future growth.
- Venture capital is a business partner sharing both the risks and rewards.
- The venture capitalist is able to provide practical advice and assistance to the company based on past experience with other companies which were in similar situations.
- The venture capitalist may be capable of providing additional rounds of funding.
- They could also be a part of economic growth.
- It could encourage new breed of entrepreneurs to take up risk.
- Moreover the venture capitalist could benefits from the growing economy and can take advantage from it.

# 6. Housing finance

Housing finance is a broad topic, the concept of which can vary across continents, regions and countries, particularly in terms of the areas it covers. ... "The purpose of a housing finance system is to provide the funds which home-buyers need to purchase their homes.

Housing industry consists of Formal or Organised and Informal or unorganized sector. Organised sector is operated by the apex body National Housing Bank (NHB), a subsidiary of RBI. The beginning of formal housing finance in India first came with the setting up of HUDCO in 1971.

**Need for housing finance**

The housing finance sector has a tremendous development impact both in terms of providing social stability and in promoting economic development.

1) Social stability: Housing finance contributes to social stability by enabling households to purchase an asset which will represent their largest single investment.
2) Economic development: Investing in housing accounts for 15% to 35% of aggregate investment worldwide. By supporting housing finance sectors the entrepreneurs (finance companies) can invest in small business. Housing constructing and housing related sectors constitute approximately 9% of the labour force worldwide

**Major institutions and banks involved in housing finance:**

- **Institutions involved in housing finance are as follows—**

1) HUDCO (Housing and Urban Development in Housing Finance).
2) LICHFL (LIC Housing Finance Limited).
3) GICHFL (GIC Housing Finance Limited).
4) DHFL (Dewan Housing Finance Corporation Limited).
5) CFHL (Can Fin Homes Limited).

- **HUDCO (Housing and Urban Development in Housing Finance).**

The Housing and Urban Development Corporation Limited (HUDCO) is a government-owned corporation in India. One of the public sector undertakings (PSU), it is wholly owned by the Union Government and is under the administrative control of the Ministry of Housing and Urban Poverty Alleviation.

This institution came into existence on 25, April, 1970 as a private limited company under the complete ownership of Indian Government with an equity base of Rs. 2 crores under the Companies Act, 1956.

The organisation provides finance for setting up of new towns and also works as consultancy services for the projects of designing and planning relating to Housing and Urban Development programs in India as well as abroad.

It also provides loans for Road and Transport, Solid Waste Management, sewerage and Drainage and Water Supply.

- **LICHFL (LIC Housing Finance Limited).**

**LIC Housing Finance Limited** (LIC HFL) is one of the largest Housing Finance companies in India having its Registered and Corporate office at Mumbai. The main objective of the Company is to provide long term finance to individuals for purchase or construction of house or flat for residential purpose / repair and renovation of existing flat / houses. The Company also provides finance on existing property for business / personal needs and also gives loans to professionals for purchase / construction of Clinics / Nursing Homes / Diagnostic Centres / Office Space and also for purchase of equipment's. The Company also provides long term finance to persons engaged in the business of construction of houses or flats for residential purpose and to be sold by them.

LICHFL Incorporated on 19 June 1989 under the Companies Act, 1956,

- **GICHFL (GIC Housing Finance Limited).**

GIC Housing Finance Ltd is a subsidiary of General Insurance Corporation of India. The company is engaged in the housing finance activity. ... The companyalso has tie-ups with corporates for various housing finance needs.GIC Housing Finance Ltd was incorporated on December 12, 1989 with the name GIC GrihVitta Ltd.

- **DHFL (Dewan Housing Finance Corporation Limited).**

**Dewan Housing Finance Corporation Ltd.** (**DHFL**) is a deposit-taking housing finance company, headquartered in Mumbai with branches in major cities across India. DHFL was established to enable access to affordable housing finance to the lower and middle income groups in semi-urban and rural parts of India. DHFL is the second housing finance company to be established in the country. The company also leases commercial and residential premises. DHFL is among the 50 biggest financial companies in India.

DHFL was established and incorporated by Rajesh Kumar Wadhawan on 11 April 1984. The name of the company was changed to Dewan Housing Development Finance Ltd. and later to Dewan Housing Finance Corporation.

- **CFHL (Can Fin Homes Limited).**

CanFin Homes Ltd, set up under the sponsorship of Canara Bank, was incorporated in the year 1987, "The International Year of Shelter for the Homeless". The main objective of setting up the company was, promoting home ownership and as well, increasing the housing stock in the country. It is the first housing company to be promoted by a nationalized bank in India.

CanFin Homes Ltd is one of the top players in the housing finance sector, in the country today. The company has completed 29 successful years of operation in the field of home finance and has a renowned history of making profits and paying dividends continuously, since inception in 1987.

- **Banks Involved in Housing Finance—**

- Scheduled Commercial Banks.
- Regional Rural Banks (RRB's).
- Agriculture and Rural Development Banks.
- Housing Development Finance Corporation Limited (HDFC).

Each and every bank has its own rules and regulations to give housing loans for the customers in the market some Regional Rural Banks will give loans for cheap rates for the people in rural areas to develop the farmers and normal rate house loans will be given to urban customers. The bank will follow the rules of interest rate which is given by the Reserve Bank of India.

**(17E00308) FINANCIAL INSTITUTIONS AND SERVICES**

**(Elective II)**

**Objective:** The objective of the course is to provide to students an understanding of Financial Markets, the major institutions involved and the services offered within this framework.

1. **Introduction**: The structure of financial system, Elements of financial system and economic development, Regulatory and Promotional Institutions - Function and Role of RBI, Monetary Policy and techniques of RBI,
2. **The Banking and Non-Banking Institutions:** The public and the private sectors – structure and comparative performance, Bank capital and Banking Innovations, Commercial and Co-operative banks. The Non-banking financial Institutions **-** Mutual Funds, Growth of Indian Mutual funds and its Regulation. The Role of AMFI, Insurance Companies- Role of IRDA.
3. **Financial and securities Markets:** Primary and Secondary Markets, Structure and functions of Money Market, -Call call money market, Government Securities Market – T-bills market, Commercial Bills market, Commercial paper and certificate of deposits. Securitiesmarkets**:** - Organization and structure, listing trading and settlement of securities market, The role and functions of SEBI
4. **Fund based services** - Lease and hire purchase consumer credit and Factoring - Definition, Functions, Advantages, Evaluation, venture capital financing, Housing Finance.
5. **Fee-based services** - Stock broking, credit rating, Merchant Banking, portfolio services. Underwriting, Depository services, Challenges faced by investment bankers.

**Text Books:**

- Financial Institutions and Markets, L. M. Bhole, 4/e Tata McGraw Hill.
- Financial services, Gorden& Natarajan, Himalaya publishers.

**References:**

- Financial Services and markets, Dr.Punithavathy Pandian, Vikas
- Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
- Indian Financial System, Ramachandra and others, HPH
- Investment Institutions and Markets, Jeff Madura, Cengage, 1st Edition.
- Financial services, Thirpati, PHI.
- Financial Markets &Services, Vasanthdesai, Himalaya.
- Financial Institutions and Markets, Gupta Agarwal, Kalyani publishers.
- Management of Financial Services ,C.Rama Gopal ,Vikas.

# UNIT-5

# FEE BASED SERVICES

## 1.INTRODUCTION

Fee based financial services do not create immediate funds the creation of funds through their services for which they charge a fee.

These services include the business of issue management either by making arrangement regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management. Fee based services are as follows.

1) STOCK BROKING.
2) CREDIT RATING.
3) MERCHANT BANKING.
4) PORTFOLIO SERVICES.
5) UNDERWRITING.
6) DEPOSITORY SERVICES.

## 2.STOCK BROKER

A **stockbroker** is a regulated professional individual, usually associated with a brokerage firm or broker-dealer, who buys and sells stocks and other securities for both retail and institutional clients through a stock exchange or over the counter in return for a fee or commission. Stockbrokers are known by numerous professional designations, depending on the license they hold, the type of securities they sell, or the services they provide.

Stockbrokers typically earn a bachelor's degree in finance or business administration. A finance degree prepares students to work as stockbrokers by focusing their studies on financial laws and regulations, accounting methods and investment management. Students study the principles of economics and currency, financial planning and financial forecasting.

On-the-job training programs are often available to aspiring stockbrokers, which allow them to gain practical experience and work towards earning the required professional licenses.

Terms used in stock broking-

1) Front office:

Stockbrokers typically earn a bachelor's degree in finance or business administration. A finance degree prepares students to work as stockbrokers by focusing their studies on financial laws and regulations, accounting methods and investment management.

Students study the principles of economics and currency, financial planning and financial forecasting. On-the-job training programs are often available to aspiring stockbrokers, which allow them to gain practical experience and work towards earning the required professional licenses.

2) Back office:

The back office is the portion of a company made up of administration and support personnel who are not client-facing. People who hold jobs in back office positions carry out functions such as settlements, clearances, record maintenance, regulatory compliance, accounting and IT services. A financial services company, for example, is logically broken up into three parts: the front office makes up sales, marketing and customer support personnel; the middle office manages risk; and the back office provides administrative and support services.

3) Prime brokerage:

Prime brokerage is the generic name for a bundled package of services offered by investment banks and securities firms to hedge funds which need the ability to borrow securities and cash in order to be able to invest on a netted basis and achieve an absolute return. The prime broker provides a centralized securities clearing facility for the hedge fund so the hedge fund's collateral requirements are netted across all deals handled by the prime broker. These two features are advantageous to their clients.

The prime broker benefits by earning fees ("spreads") on financing the client's margined long and short cash and security positions, and by charging, in some cases, fees for clearing and other services. It also earns money by rehypothecating the margined portfolios of the hedge funds currently serviced and charging interest on those borrowing securities and other investments.

4) Retail broker:

In the world of investments, a broker is someone who acts as the middleman between buyers and securities sellers. Brokers are typically required to register with the Securities and Exchange Commission and with a self-regulatory organization, such as the Financial Industry Regulatory Authority. Brokers who work primarily with institutional investors are referred to as institutional brokers, while those who serve the needs of individual investors are called retail brokers.

5) Low cost /discount broker:

A discount broker or an online broker is a firm that charges a relatively small commission by having its clients perform trades via automated, computerized trading platforms rather than by having an actual stockbroker assist with the trade. Most traditional brokerage firms offer discount options and compete heavily for client volume due to a shift towards this method of trading.

Other ways to lower costs for these brokers is by executing orders only a few times a day by aggregating orders from a large number of small investors into one or more trades which are made at certain specific times during the day. They help lower costs in two ways:

- By matching buy and sell orders within the firm's order book, the overall quantity of stock to be traded can be reduced, thus reducing commissions payable to others by the brokerage firm.
- The broker can split the bid-ask spread with the investor when matching buy and sell orders - a win-win situation in most cases

Since investor money is pooled before stocks are bought or sold, it enables investors to contribute small amounts of cash with which fractional shares of specific stocks can be purchased. This is usually not possible with a regular stockbroker.

6) Boutique broker:

A boutique is a small financial firm that provides specialized services for a particular segment of the market. Boutique firms are most common in the investment management or investment banking industries. These firms may specialize by industry, client asset size, banking transaction type or other factors to address a market not well-addressed by larger firms.

Smaller players in the financial segment may prosper by positioning themselves to serve a specific niche. Although they may lack some of the resources of larger firms, boutique firms aim to offer more individualized services and tailor their offerings to the needs of their clients. Boutique firms are often founded by former employees of larger firms who wish to strike out on their own. Working at a boutique firm offers an alternative for finance professionals who are looking for something different from the large-firm experience.

**Types Of Brokers**–

**1) Full service broker-**

A full-service broker is a licensed financial broker-dealer firm that provides a large variety of services to its clients, including research and advice, retirement planning, tax tips, and much more. Of course, this all comes at a price, as commissions at full-service brokerages are much higher than those at discount brokers. Full-service brokers can provide expertise for people who don't have the time to stay up-to-date on complicated issues such as tax or estate planning.

Full-service brokers offer customized support and interaction in facilitating trades, managing portfolios, financial planning and wealth management services for clients. Clients are assigned to individual stockbrokers and/or financial advisors. They are main point of contact at a full service firm.

Full-service firms have large research departments with analysts that provide proprietary detailed reports and recommendations for clients. They also have investment banking divisions that may provide certain accredited investor clients access to special financial products such as initial public offerings (IPOs), senior notes, preferred stock, debt instruments, limited partnerships and various exotic and alternate investment opportunities. This is one of the main advantages of full-service firms. Full-service brokers often have their own in-house line of products like mutual funds, portfolio management, insurance, loan services and exchange-traded funds (ETFs). All full-service brokerages provide physical office locations for clients to visit.

Clients of full-service brokerages appreciated the convenience of having a personal broker handle all their investment needs. It is a one-stop shop for investment and financial management. Most full-services firms provide online access and trading platforms. Self-directed investors tend to take advantage of these offerings. These platforms are loaded with fundamental research, order execution and technical analysis tools.

**2) Discount brokers:**

A discount broker is a stockbroker who carries out buy and sell orders at a reduced commission compared to a full-service broker but provides no investment advice. Before the emergence of technology, only the wealthy could afford a broker and get access to the stock market. However, the internet has brought an explosion of discount brokers that let individuals with smaller capital to trade at a smaller fee.

Unlike full-service brokers, discount brokers do not provide personal consultations, advice, research, tax planning, and estate planning services for customers.

**Role of stock brokers**:

1) Buying.
2) Selling.
3) Research.
4) Marketing.

**SEBI guidelines for stock broking**:

- Application for registration of Stock Brokers.
- Furnishing of information, clarification.
- Consideration of application for grant of registration.
- Procedure for registration.
- Procedure when registration is not granted.
- Payment of fees.
- Conditions for registration.
- Approval for operation in segments of stock exchange.
- Registration as sub-broker
- Application for registration as sub broker
- Procedure for registration.
- Conditions of registration.

- Procedure when registration is not granted.
- General obligations and inspection.
- Director not to act as sub-broker.
- To maintain proper books of account, records, etc.
- Maintenance of books of account and records.
- Appointment of Compliance officer.
- Stock Broker not to deal with unregistered Sub-broker.
- Board's right to inspect.
- Procedure for Inspection.
- Obligations of stock-broker on inspection by the Board.
- Submission of report to the Board.
- Action on inspection or investigation report.
- Appointment of Auditor.

## 3.CREDIT RATING

A **credit rating** is an evaluation of the credit risk of a prospective debtor (an individual, a business, company or a government), predicting their ability to pay back the debt, and an implicit forecast of the likelihood of the debtor defaulting.The credit rating represents an evaluation of a credit rating agency of the qualitative and quantitative information for the prospective debtor, including information provided by the prospective debtor and other non-public information obtained by the credit rating agency's analysts.

An assessment of the creditworthiness of a borrower in general terms or with respect to a particular debt or financial obligation. A credit rating can be assigned to any entity that seeks to borrow money – an individual, corporation, state or provincial authority, or sovereign government. Credit assessment and evaluation for companies and governments is generally done by a credit rating agency such as Standard & Poor's, Moody's or Fitch. These rating agencies are paid by the entity that is seeking a credit rating for itself or for one of its debt issues.

A loan is essentially a promise, and a credit rating determines the likelihood that the borrower will pay back a loan within the confines of the loan agreement, without defaulting. A high credit rating indicates a high possibility of paying back the loan in its entirety without any issues; a poor credit rating suggests that the borrower has had trouble paying back loans in the past, and might follow the same pattern in the future.

The credit rating affects the entity's chances of being approved for a given loan, or receiving favourable terms for said loan.
Credit ratings apply to businesses and government, while credit scores apply only to individuals. (An individual's credit score is reported as a number, generally ranging from 300 to 850. For details, see *What Is a Good Credit Score?*) Similarly, sovereign credit ratings apply to national governments, and corporate credit ratings apply solely to corporations.

Credit rating agencies typically assign letter grades to indicate ratings. Standard & Poor's, for instance, has a credit rating scale ranging from AAA (excellent) and AA+ all the way to C and D.

A debt instrument with a rating below BBB- is considered to be speculative grade or a junk bond, which means it is more likely to default on loans.

**Functions of Credit rating agencies:**

**1. Business Analysis:**

A credit rating company will analyse the business condition of the borrowing company not merely by the profits the borrowing concern has made, but by the use of capital in a more productive purpose. The return on capital and the cost of capital will be analysed.

**2. Evaluation of industrial risks:**

Every industry will have its risks which are due to natural or market conditions such as competition or due to the substitutes that have arrived in the market. The extent of risks and measures to overcome them will be taken into account while judging the credit rating of the company.

**3. Market position of the company within the industry:**

What is the share of the market of the company seeking credit rating? A higher percentage of market share will involve more risks as the company has to be vigilant to maintain its share. So, a credit rating agency will give due weightage for the market share of the borrowing concern.

**4. Operating efficiency:**

This is judged from the point of view of utilization of the capacity. When full capacity is utilized, the company has an advantage over others. This may be possible due to location advantage or better labour relations. These will be looked into by the credit rating agency.

**5. Legal position in terms of prospectus:**

The statements made in the prospectus, should be true and factual. If tall claims are made, they will hamper the growth of the company and the credit rating agency will not rely on the prospectus of the company. It may also be construed as a wilful fraud for attracting more funds. So, the contents of prospectus will also be a factor for credit rating considerations.

**6. Financial analysis based on accounting quality:**

If accrued incomes are taken for making a window-dressing of balance sheet, it will not reflect well on the quality of accounting of the borrowing concern. Companies relying on realized income, will be in a better position to provide a realistic balance sheet. So, the true financial position of the company will be judged not merely on the books of accounts but also on their market conditions in meeting their debt commitments.

**7. Statement of profits:**

There may be over statement or understatement of profits depending upon the purpose for which the statement is prepared. Here, again the credit rating agency has to scrutinize the realistic position of the company.

**8. Earnings protection:**

To what extent, the earnings of the companies are consistent? Does it show any growth? What is the extent of profitability? All these will be judged under this criterion.

**9. Adequacy of cash flow:**

Is the cash flow sufficient to meet its current commitments as well as any other contingencies? This factor is taken into consideration by the rating agencies.

**10. Financial flexibility:**

How far the company is in a position to arrange for alternative financial plans for raising its funds, if its existing idea does not work out successfully? Rating agencies adjudge the financial flexibility of companies.

**11. Management evaluation:**

What is the track record of management? How far they are successful in steering the company under difficult conditions? Evaluation of management is one of the important functions of credit rating agencies.

**12. Capacity to overcome adverse situations (catastrophe management):**

Rating agency studies the available mechanism for recovery with the company for meeting any sudden unforeseen calamities.

**13. Goals philosophy and strategy:**

Here, what kind of organizational goals are adopted? What are the strategies adopted for achieving the goals, etc.? Such aspects are considered when evaluation of an organization by rating agency.

**14. Labour turnover:**

How far the nonalignment is looking after the welfare of its labour? What is the extent of punctuality, discipline and morale of the labour force? To what extent they continue with the employment in the company? A rating agency looks for all these issues.

**15. Regulatory and competitive environment:**

If there are more regulations, restricting competition, then there will be more protection to the company, whereas under condition of deregulation, providing more scope for competition, the efficiency of the company will be tested. A rating agency studies the regulatory and competitive environment from these angles.

**16. Asset quality:**

Here, the value of assets and the price of the assets according to the market conditions and the provisions made for these assets will be taken into account credit rating authorities. Performance of assets will also be taken. The extent of standard, substandard, doubtful and bad assets will also be taken into account while granting credit rating.

**17. Financial position — interest / tax sensitivity:**

If there is increase in the interest rate due to the market condition, how far the company will be able to bear it? What will be the impact on the company's earnings? Similarly, if the government increases tax on income, what will be the tax burden? What impact it will have on the company's earnings. These factors are taken into consideration.

These are some of the functions of credit rating agencies in rating a company. You may also like to read some of the benefits of credit ratings.

## 4.MERCHANT BANKING

A merchant bank is a company that deals mostly in international finance, business loans for companies and underwriting. These banks are experts in international trade, which makes them specialists in dealing with multinational corporations. A merchant bank may perform some of the same services as an investment bank, but it does not provide regular banking services to the general public.

One role of a merchant bank is to provide financing to large corporations that do business overseas. Assume, for example, that XYZ Company is based in the United States and decides to purchase a supplier that is based in Germany.

**Objectives of Merchant Banking**:

- It provides financial assistance to venture capital.
- To contribute the country in the development of Capital Market.
- To constantly strive to achieve superior results for each client and investors of capital market and encourage prospective investor in capital market.
- Good corporate governance and wealth maximization of company and its stakeholders.
- To provide high quality services that combines performance with value pricing through successful and trusted relationship with our clients.
- To provide investment advisory and professional business services to emerging and midsize business entities, government bodies and high net worth individuals.
- To build and maintain leadership in the domestic financial services industry through prudent and strategic growth led by our merchant banking activities.
- To maintain complete integrity and use outmost discretion in all business dealings.
- To ensure client satisfaction.
- Capital issues management, Private Placement of the securities and corporate counseling.

- Project counseling and Portfolio management services.
- Management of mergers and amalgamation.
- Financial Engineering or Capital Restructuring and Re-organization.
- Underwriting of share, debenture and bonds etc.

Functions or Role of Merchant Banks:

Some of the most important functions or role of merchant banks is as follows

1) Underwriter.
2) Banker.
3) Broker.
4) Register.
5) Portfolio manager.

**5.Underwriter**

An underwriter is any party that evaluates and assumes another party's risk for a fee, such as a commission, premium, spread or interest. Underwriters operate in many aspects of the financial world, including the mortgage industry, insurance industry, equity markets, and common types of debt securities.

**Banker**

Banker who are engaged in the function of acceptance of application for shares and debentures along either application money from investors in respect of issue of securities and also refund of application money to the applicants to whom securities could not be allotted are called bankers to an issue.

**Broker**

A broker is an individual or firm that charges a fee or commission for executing buy and sell orders submitted by an investor. A broker also refers to the role of a firm when it acts as an agent for a customer and charges the customer a commission for its services.

The brokerage applicable to all types of public issue of industrial securities is fixed at 1.5% whether the issue is underwritten or not.

**Registrar**

Registrar is as an intermediary in the primary market carry on activities such as collecting applications from investors keeping a proper record of applications and money received from investors or paid to the sellers of securities and assisting companies in determining the basis of allotment of securities in consultation with stock exchanges.

**Portfolio manager:**

A portfolio manager is a person or group of people responsible for investing a mutual, exchange-traded or closed-end fund's assets, implementing its investment strategy and managing day-to-day portfolio trading. A portfolio manager is one of the most important factors to consider when looking at fund investing. Portfolio management can be active or

passive, and historical performance records indicate that only a minority of active fund managers consistently beat the market.
the term portfolio means the total holding of securities belonging to any persons.

## 6.PORTFOLIO SERVICES

Portfolio management is the art and science of making decisions about investment mix and policy, matching investments to objectives, asset allocation for individuals and institutions, and balancing risk against performance.

Portfolio management is all about determining strengths, weaknesses, opportunities and threats in the choice of debt vs. equity, domestic vs. international, growth vs. safety, and many other trade-offs encountered in the attempt to maximize return at a given appetite for risk.

**Objectives of portfolio services:**

- **Stable Current Return:** Once investment safety is guaranteed, the portfolio should yield a steady current income. The current returns should at least match the opportunity cost of the funds of the investor. What we are referring to here current income by way of interest of dividends, not capital gains.
- **Marketability:** A good portfolio consists of investment, which can be marketed without difficulty. If there are too many unlisted or inactive shares in your portfolio, you will face problems in encasing them, and switching from one investment to another. It is desirable to invest in companies listed on major stock exchanges, which are actively traded.
- **Tax Planning:** Since taxation is an important variable in total planning, a good portfolio should enable its owner to enjoy a favorable tax shelter. The portfolio should be developed considering not only income tax, but capital gains tax, and gift tax, as well. What a good portfolio aims at is tax planning, not tax evasion or tax avoidance.
- **Appreciation in the value of capital:** A good portfolio should appreciate in value in order to protect the investor from any erosion in purchasing power due to inflation. In other words, a balanced portfolio must consist of certain investments, which tend to appreciate in real value after adjusting for inflation.
- **Liquidity:** The portfolio should ensure that there are enough funds available at short notice to take care of the investor’s liquidity requirements. It is desirable to keep a line of credit from a bank for use in case it becomes necessary to participate in right issues, or for any other personal needs.
- **Safety of the investment:** The first important objective of a portfolio, no matter who owns it, is to ensure that the investment is absolutely safe. Other considerations like income, growth, etc., only come into the picture after the safety of your investment is ensured.

Registration of portfolio manager:

- A portfolio manager advises or undertakes on behalf of his client to manage a portfolio of securities or the funds of the client. He may either be a discretionary portfolio manager or a non-discretionary portfolio manager. A discretionary portfolio manager individually and independently manages the funds of each client in accordance with the needs of the client, whereas a non-discretionary portfolio manager manages the funds in accordance with the directions of the client.

An applicant for registration as a portfolio manager is required to pay a non-refundable application fee of Rs 1 lakh to the Securities and Exchange Board of India (Sebi). Every portfolio manager is required to pay a sum of Rs 10 lakhs as registration fees at the time of grant of certificate of registration by Sebi. SEBI takes into account all matters which it deems relevant to the activities relating to portfolio management. The applicant has to be a body corporate and must have necessary infrastructure like adequate office space, equipment and the manpower to effectively discharge the activities of a portfolio manager.

The principal officer of the applicant should have professional qualifications in finance, law, accountancy or business management from an institution recognised by the Government.

The applicant should have in its employment a minimum of two persons who, between them, have at least five years' experience as portfolio managers, stock brokers, investment managers, or in areas related to fund management. The applicant also has to fulfil the capital adequacy requirements etc.

The portfolio manager is required to have a minimum net worth of Rs 50 lakhs. The certificate of registration by SEBI remains valid for three years. The portfolio manager, before taking up an assignment of management of funds or portfolio of securities on behalf of the client, enters into an agreement in writing with the client. It should clearly define the relationship and set out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities. It should contain the details as specified in Schedule IV of the SEBI (portfolio managers) Regulations 1993.

**7.DEPOSITORY SERVICES**

Depository is an organisation which holds your securities in electronic (also known as 'book entry') form, in the same manner as a bank holds your money. Further, a depository also transfers your securities without actually handling securities, in the same day as a bank transfers funds without actually handling cash.

**Need for Depository System:**

The trading in physical segment is full of inefficiencies due to handling of large volumes of certificates and also involves various other problems like delays in transfer, delay in settlement, loss in transit, forgery certificates, stolen certificates, mutilation of certificates, postal losses, court cases, litigation etc.

To overcome these deficiencies, a new system of trading, viz. Depository system was introduced, which facilitates investor to hold securities in electronic form and to trade in these securities. The first depository set up in India is National Securities Depository Limited (NSDL) and is promoted by IDBI, UTI and NSE.

There are two types of depository systems in the country, they are

a) NSDL (NATIONAL SECURITY DEPOSITORIES LIMITED).
b) CDSL (CENTRAL DEPOSITORY SERVICES LIMITED).

Activities of depository services:
The various activities of depository services are as follows—

1) Opening of depository account.
2) Dematerialisation.
3) Rematerialisation.
4) Settlement of trades in dematerialised securities.
5) Account transfer.
6) Redemption or repurchase.
7) Account freezing.
8) Nomination.
9) Dealing in government securities.

**Benefits of Depository System:**

1. No danger of loss of share certificates since the shares are credited to your account.
2. No possibility of bad deliveries.
3. Elimination of all rise associated with physical certificates such as loss, theft, forgery, mutilation etc.
4. No need to affix share transfer stamp as it is a paperless trading.
5. No postal / courier charges.
6. Less brokerage charges.
7. After the settlement, pay in and pay out are on the same day for paperless trading which means you get your securities and cash immediately.
8. Script less trading helps allocate corporate benefits faster.

9. Facilitates pledging and hypothecation of your securities.

10. Eliminates the problem of odd lot shares.

11. Facility to lock your account if you are abroad.

**National Securities Depository Limited (NSDL)**

National Securities Depository Limited (NSDL) National Securities Depository Limited (NSDL) was promoted by the Industrial Development Bank of India, the Unit Trust of India, the National Stock Exchange of India Ltd., and State Bank of India.

NSDL is the first depository in India established in 1996. It commenced its operations on 8th November 1996. Since then it has been growing steadily.

**Functions of National Securities Depository Ltd**

NSDL performs the following functions through its participants:

1. It maintains investors' holdings in the electronic form.

2. It enables the surrender and withdrawal of securities to and from the depository.

3. If effects settlement of securities traded on exchanges.

4. It carries out settlements that have not been done on the stock exchanges.

5. It makes allotment in electronic form, of initial public offerings (IPO).

6. It offers facility for freezing or locking of investors' accounts.

7. It facilitates offer of securities as a mortgage for loans.

**Services offered by NSDL:**

The following services are offered by NSDL to the investors, through its agents viz. Depository Participants.

1. Holding the investors securities in electronic form.
2. Dematerialisation and rematerialisation of securities.
3. Settlement of trades in electronic form.
4. Electronic credit of public offerings and non-cash corporate actions such as rights, bonus etc.

**Steps involved in joining depository system:**

There are 3 steps in which an investor can covert his physical certificate into electronic form.

1. Open an account with one of the participants of NSDL (A participant is a market intermediary through whom NSDL interacts with the investors).
2. Sign an Agreement with the participant.
3. Submit Dematerialisation Request form along with share certificate to the Issuer.

**CENTRAL DEPOSITORY SERVICES LIMITED (CDSL)**

Central Depository Services Limited (CDSL) is a depository service that works for the Bombay Stock Exchange (BSE) and is promoted by the State Bank of India (SBI), Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank, Axis Bank and the Union Bank of India.

The primary function of this depository is to hold securities either in certificated or un-certificated (dematerialized) form, and it helps enable the book-entry transfer of securities up to 500 shares in physical form. However, most traders have now adapted to the electronic format for trading in securities.

CDSL's primary focus is to provide safe, useful, reliable and secure depository services. CDSL began its operations from February 1999 onwards after obtaining prior clearance from market watchdog Securities and Exchange Board of India (SEBI).

A Depository Participant (DP) offers depository services to investors. According to SEBI-issued regulations, financial institutions, banks, custodians, and stockbrokers are eligible to act as DPs. The DP is a CDSL-authorized agent who serves as a link between the account holder or Beneficial Owner (BO), the issuing company, CDSL, the BO's broker and the Stock Exchange

Investors using depository services of the depository is known as the Beneficial Owner (BO), and they have to maintain a demat account to access the functions of the CDSL, including the facilities of dematerialization and transferring of securities. When the investor's purchases securities, they are automatically credited to the depository account, and when those securities are sold, they are automatically debited from the investor's depository account.

**Benefits of holding demat securities in CDSL:**

- As the share certificates are in an electronic format, the investor is safe from the risk of theft, loss or damage to the physical share certificates.

- The investor need not be skeptical about the genuineness of the securities purchased as the securities in the depository cannot be returned under objection for any reason, and it also eliminates the risk of bad delivery.
- The securities are immediately transferred to the investor's account as soon as the payment is transferred to the company's account. There is no need for the investor to wait for the registration process from the company or its Registrar.
- The stock exchanges follow the method of T+2 rolling settlement cycle, i.e. settlement of trades is done on the 2nd working day from the trade. This action is possible because dematerialized securities have paved the way for liquidity and swift transfer of securities.
- No stamp duty is applicable for investors when transferring securities in dematerialized format.
- Companies can directly credit their investors account in case of bonus issue or rights issue of shares.
- Any update or changes in the personal information or transmission of the BO can be directly updated with the CDSL. A single standing instruction to the CDSL would help the investor update their details with all companies in which they have a vested interest.
- The CDSL also sends the investor a statement that consolidates the position of all their holdings. This would enable investors to make informed decisions about their financial strategy.

A depository can be compared to a bank. A depository holds securities of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities.

A depository interfaces with its investors through its agents called Depository Participants (DPs). If an investor wants to utilise the services offered by a depository, the investor has to open an account with a DP. This is similar to opening an account with any branch of a bank in order to utilise the bank's services.

**8. CHALLENGES FACED BY INVESTMENT BANKERS**

- Investment banks need to identify and strengthen core businesses that could drive growth and increase competitiveness in a market featuring increased regulatory burdens and a shrinking revenue pool.

- Investment banks of all sizes have to take a systematic view of the new environment due to regulation, market structure changes and technological possibilities to try to restore their overall profitability.

- In order to make the best of this technology, banks need to examine their existing operational systems and determine where block chain could add the most value in the long run.

- Financial technology (fintech) represents both a great potential for disruption and an opportunity for investment banks. In order to make the most of fintech, banking leaders need to develop a holistic framework that is built on a cohesive innovation architecture and one that utilizes meaningful partnerships and incubation programs.

- Infrastructure-as-a-Service (IaaS) and Platform-as-a-Service (PaaS) cloud solutions could reduce banks' costs, as well as simplify and standardize IT estates. The adoption rates are now accelerating across capital markets for both private and public solutions.

- To meet evolving client expectations and preferences, investment banks must determine which silos to tear down to deliver an appropriate client experience.

- To succeed in the future, investment banks might need to ramp up their efforts to attract and retain the best and brightest. That means introducing new ways of working, making jobs more appealing, and creating a workplace that encourages collaboration and values creativity.

- Historically, investment banks have chosen to give away research for free in the hope of attracting trading commissions in the future. In turn, they used investment banking fees from initial public offerings (IPOs) to support research activity. That all changed with recent regulations, which set out to separate research from investment banking activities and prevent companies from disclosing information to research analysts before it is publicly available. As a result, the opportunity of sell-side analysts to provide quality research and alpha-generating ideas has been greatly diminished.