PERIYAR UNIVERSITY

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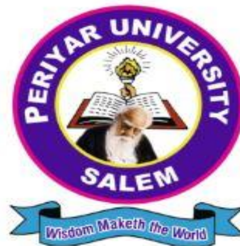
SALEM - 636 011, Tamil Nadu, India.

CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

BACHELOR OF BUSINESS ADMINISTRATION

SEMESTER - V



ELECTIVE COURSE: FINANCIAL SERVICES

(Candidates admitted from 2024 onwards)

PERIYAR UNIVERSITY

CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

B.B.A 2024 admission onwards

ELECTIVE – V
Financial Services

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FINANCIAL SERVICES

UNIT 1 - FINANCIAL SERVICES

Meaning and importance of financial services – Types of financial services – Financial services and economic and technological environment – Players in Financial Services Sector. Financial Environment; Financial System, RBI, Commercial Banks; Financial Institutions-National Stock Exchange; Non-Banking Financial Companies (NBFCs)

In this unit, learners will have a comprehensive understanding of financial services and financial institutions, including their roles, functions, and the impact they have on the economy. Learners will be able to analyze different types of financial institutions, understand the range of financial services they provide, and evaluate the regulatory environment in which these institutions operate.

SECTION 1.1: FINANCIAL SERVICES - AN INTRODUCTION

Financial services consist of services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested. They assist to determine the financing combination and extend their professional services up to the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. These range from the leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses. The financial services sector offers a number of professional services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. Financial institutions and financial markets help in the working of the financial system by means of financial instruments. To be able to carry out the jobs

given, they need several services of financial nature. Therefore, financial services are considered as the 4th major component of the financial system.

1.1.1 – Meaning and Definition of Financial Services

Financial services refer to services provided by the finance industry. The finance industry consists of a broad range of organizations that deal with the management of money. These organizations include banks, credit card companies, insurance companies, consumer finance companies, stock brokers, investment funds and some government sponsored enterprises.

Financial services may be defined as the products and services offered by financial institutions for the facilitation of various financial transactions and other related activities.

Financial services can also be called financial intermediation. Financial intermediation is a process by which funds are mobilized from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers. There are various institutions which render financial services. Some of the institutions are banks, investment companies, accounting firms, financial institutions, merchant banks, leasing companies, venture capital companies, factoring companies, mutual funds etc. These institutions provide variety of services to corporate enterprises. Such services are called financial services. Thus, services rendered by financial service organizations to industrial enterprises and to ultimate consumer markets are called financial services. These are the services and facilities required for the smooth operation of the financial markets. In short, services provided by financial intermediaries are called financial services.

1.1.2 - Financial Services in India – An Overview and Recent Developments

Indian Demand: India's financial services sector is poised to grow on the back of rising incomes, significant government attention and the increasing pace of digital

adoption. The long term fundamentals of the sector are sound, but the Indian Government's openness to private players and foreign participation is likely to remain patchy.

Indian Supply: Fast digital adoption from consumers and skilled IT clusters, such as those in Hyderabad and Bangalore, will continue driving the expansion of India's fintech industry, which is expected to double between 2016 and 2020 to $3.2 billion

- The rate of technological change makes it difficult to forecast long term projections of the size of the fintech market in India.

The development of India's technological and entrepreneurial ecosystem will make it easier to expand the financial services market into regional and rural areas, while financial inclusion has been a focus of Indian policy makers for decades progress is now being seen and new technologies are now making it viable

Indian fintech companies are driving change by specialising in targeted services along specific parts of the value chain which were previously the domain of brick and mortar companies

- India offers the highest expected return on investment on fintech projects, at 29 per cent (not risk adjusted) versus a global average of 20 per cent.
- India's mutual funds segment is sizeable, equivalent to approximately one-tenth of the country's GDP.
- Growth prospects are good, given India's high savings rate and its well-developed equity market.

The equity mutual funds market, with a boost from demonetisation, saw its assets under management cross $430 billion in 2017, double what it was three years earlier

- |Further development in the mutual funds sector will be hampered by modest demand beyond tier one cities, a lack of asset class diversity and narrow pension coverage.

India's pension system is at a nascent stage, dealing with challenges related to customer awareness, penetration and regulation

- India's regulatory framework limits investment avenues for money raised through pensions. However, this is changing with the Employees' Provident Fund Organisation granted approval to invest a part of its assets into exchange traded funds.

New technologies and rising consumer expectations will re-shape the sector globally. The financial services industry is on the cusp of substantial change

- Rapidly advancing technologies, rising consumer expectations and disruptive innovations will reshape the structure of the industry across the globe.

Changes to India's financial system: The pace of change in India's financial system has the potential to be faster than in other countries due to the rapid take up of digital devices combined with India's track record of frugal innovation.

Technology leapfrogging in telecommunications, in which India will jump past the fibre cable stage to mobile network infrastructure, will be central to the future development of India's financial services sector

Other digitisation projects, such as the United Payment Interface and associated mobile application Bharat Interface for Money – a safe, instant payment system – and DigiLocker, a cloud based platform for authentication and sharing of identity documents, will be linked to customers through Aadhaar

By 2025, digital finance is forecast to boost India's GDP by $950 billion and create 21 million new jobs. With an assist from the demonetisation campaign, the digital payments sector in India is expected to benefit the most from rising technological adoption in India. Nearly 80 per cent of all customer transactions in new private banks are conducted through digital channels

Adoption of new technologies and processes, including block chain ledgers, could reduce the cost of managing loans and make micro financing commercially feasible

- The NITI Aayog-led IndiaChain plans to implement a fully-fledged block chain infrastructure that uses 'electronic Know Your Customer' and Aadhaar to reduce fraud, speed up enforcement of contracts and increase transparency of transactions
- Micro-financing for commercial purposes will require a change in India's banking culture, which has traditionally preferred to lend large amounts to limited clients rather than lending small amounts at scale
- While India's incumbent players may not be agile enough to adjust, they are unlikely to hinder new firms that may look to service this market.

The need for cyber security and personal data privacy will inform how financial institutions approach off-shoring, data storage and the use of big. Fintech start-ups are already encroaching on established financial services markets. Consumers are showing signs of preferring non-traditional financial service providers, largely due to more targeted product offerings and a greater focus on customer choice and experience, especially in areas of payments, loans and personal finance information tools.

The most successful Indian fintech company to date has been Paytm, an electronic payment and e-commerce giant with over 200 million users.

In financial services, brand loyalty and effectiveness of discounts will decline as value will increasingly be derived from the degree of personalisation and adaptability of the product.

1.1.3 Nature or Characteristics of Financial Services

1. **Intangibility**: Financial services are intangible. Therefore, they cannot be standardized or reproduced in the same form. The institutions supplying the financial services should have a better image and confidence of the customers. Otherwise, they

may not succeed. They have to focus on quality and innovation of their services. Then only they can build credibility and gain the trust of the customers.

2. Inseparability: Both production and supply of financial services have to be performed simultaneously. Hence, there should be perfect understanding between the financial service institutions and its customers.

3. Perishability: Like other services, financial services also require a match between demand and supply. Services cannot be stored. They have to be supplied when customers need them.

4. Variability: In order to cater a variety of financial and related needs of different customers in different areas, financial service organisations have to offer a wide range of products and services. This means the financial services have to be tailor-made to the requirements of customers. The service institutions differentiate their services to develop their individual identity.

5. Dominance of human element: Financial services are dominated by human element. Thus, financial services are labour intensive. It requires competent and skilled personnel to market the quality financial products.

6. Information based: Financial service industry is an information based industry. It involves creation, dissemination and use of information. Information is an essential component in the production of financial services.

1.1.4 Functions of Financial Services

- **Enables payment system:** Financial services have a key role in the proper movement of funds among peoples. It enables peoples to successfully do their payments without any difficulty. Credit cards, debit cards, bill of exchange, and cheque are such financial instruments which facilitate financial transactions.
- **Proper Utilization of Funds:** These intangible services help in efficient allocation of funds. Financial services serve as a means through which peoples invest their ideal lying resources into better investment plans for generating incomes.

- **Maintains Liquidity:** Financial services helps in maintaining sufficient funds in an economy. It links the one who is in need of funds and those who can supply funds as they have sufficient savings. Various services like loans and credit cards enable people to acquire needed funds easily.
- **Raises Standard of living:** These services play a crucial role in improving the living standards of people. Customers are easily able to purchase costly goods on hire purchase system availing these services. People are able to enjoy the benefits of quality and luxury items.
- **Promotes trade**: Financial services promote both domestic and foreign trade in a country. Forfaiting and factoring companies in the financial market promote the export of goods to foreign markets and also the sales of products in the domestic market. In addition to this insurance and banking facilities also support trade activities in-country.
- **Improve Employment Opportunities:** Generation of employment opportunities is another important function of financial services. Different financial institutions employ a large number of peoples for selling these services. They pay remunerations to their employees out of the profit earned by selling these financial services.
- **Balanced Regional Development:** Financial services helps in the balanced regional development of the country. All the key sectors of the economy such as the primary sector, secondary sector, and tertiary sector are able to acquire the required funds through these services. This results in regional disparities and brings balanced development in a country.

1.1.5 Importance of Financial Services

The successful functioning of any financial system depends upon the range of financial services offered by financial service organisations. The importance of financial services may be understood from the following points:

1. Economic growth: The financial service industry mobilises the savings of the people, and channels them into productive investments by providing various services to people in general and corporate enterprises in particular. In short, the economic growth of any country depends upon these savings and investments.

2. Promotion of savings: The financial service industry mobilises the savings of the people by providing transformation services. It provides liability, asset and size transformation service by providing huge loan from small deposits collected from a large number of people. In this way financial service industry promotes savings.

3. Capital formation: Financial service industry facilitates capital formation by rendering various capital market intermediary services. Capital formation is the very basis for economic growth.

4. Creation of employment opportunities: The financial service industry creates and provides employment opportunities to millions of people all over the world.

5. Contribution to GNP: Recently the contribution of financial services to GNP has been increasing year after year in almost countries.

6. Provision of liquidity: The financial service industry promotes liquidity in the financial system by allocating and reallocating savings and investment into various avenues of economic activity. It facilitates easy conversion of financial assets into liquid cash.

1.1.6 Types of Financial Services

Financial services are divided into traditional and modern activities. The traditional ones are the ones from the past financial intermediaries.

I. Traditional Activities

a) **Fund/Asset-Based Financial Services:** These financial services are to make assets or are backed by them. The collected funds are converted into assets by businesses. Read below its types.

- **Lease financing**: This contract offers usage rights for an asset. A person gets to use an asset for a fixed time. The owner gets a fee or fixed money for the same.
- **Hire purchase**: Another financial services type is hire purchase. An individual or company can hire an asset for use. The contract is for a set period. After which, they have to buy the asset.
- **Factoring**: Factoring happens when companies need quick cash. They may sell instruments like bills and receivables at a discount.
- **Forfeiting**: These financial services help discount receivables for an international transaction. It helps provide flexible payments.
- **Mutual funds**: These financial services allow investors to invest in shares even with a small amount. Mutual funds collect money from investors. They put those funds in several different shares.
- **Exchange-traded funds:** These instruments have assets like stock, bonds, or commodities. They are traded just like shares.
- **Consumer credit or finance**: These services help customers buy daily-use goods. They may be through deferred payments, instalment plans, credit buying, etc.
- **Bill discounting**: Financial services help people liquidate their money market instruments. Bills receivables are among them.
- **Housing finance**: These financial services fund the client's housing needs.
- **Venture capital**: These financial services are for new businesses. They help start a business with the initial funding.

b) Fee/Non-Fund Based Financial Services: These services allow businesses and individuals to create funds through charged services. Read below the different types.

- **Merchant banker**: These services include institutions or individuals allocating securities. They also have other facilities like advisory, mergers and acquisitions, broker services, etc.

- **Credit rating:** These are institutions that rank the creditworthiness of an individual or body. It helps lenders understand whether they should lend money to that organization.
- **Stock broking**: Financial services also allow trade in the stock exchanges. It brings the securities sellers and buyers together.
- **Securitization**: It refers to when assets are converted into securities for trade. They are sold in markets to raise funds. For example, loans can be raised through bonds.
- **Letters of credit**: These financial services mention the repayment promise by the buyer's bank to the seller. It is for a goods sale.
- **Bank guarantees**: These are by the buyer's bank to the seller. This guarantee makes the bank liable to pay if the buyer doesn't.

II. Modern Activities

These modern activities are offered along with the traditional ones. These are the new financial products. Read about them below.

- Financial services provide project advisory. They help in the project's beginning, funding, and approvals. It is essential for new businesses.
- It includes the preparation and necessities of the merger and acquisition steps.
- Financial services also offer advisory for capital restructuring in companies.
- Some businesses also act as trustees for debenture holders.
- Financial services help reform the management style or structure. They suggest changes for the same.
- They facilitate joint ventures. Financial services can help find partners and structure the new venture.
- It facilitates the rehabilitation and recovery of sick businesses. They can get back to profitable ventures.
- Financial services offer derivatives and swap products. They help reduce financial risks.

- Financial services manage profiles and portfolios of corporate and individual clients.
- The companies offer insurance and buy-back options to manage risks.
- Financial services help choose the best funding options. They understand the company's needs and budget.
- Financial services allow for lowering the debt cost for companies. It also suggests measures for debt and equity ratios.
- It assists companies in going public. Also, they include credit rating bodies.
- Financial services also have capital market facilities like registration and transfers, clearing houses, safe custody, and securities income.

Let's Sum Up

Learners, in this section we have seen that financial services refer to a broad range of economic services provided by the finance industry, which encompasses various businesses that manage money. These services facilitate the transfer of funds between savers and borrowers, ensuring efficient allocation of resources, risk management, and the smooth functioning of financial markets. The financial services sector is integral to the economy, supporting both personal and business financial activities. And, also we have seen the types of financial services, it is divided into two categories namely, traditional and modern services. Each type of financial service plays a critical role in supporting economic stability and growth, providing individuals and businesses with the tools and resources needed to manage their financial activities effectively.

Check your Progress

1. What are financial services primarily concerned with?

A. Production of goods

B. Distribution of wealth

C. Agricultural activities

D. Environmental conservation

2. Which of the following is NOT considered a financial service?

A. Banking

B. Insurance

C. Manufacturing

D. Investment management

3. What is the primary objective of asset management services?

A. Issuing credit cards

B. Maximizing profits for shareholders

C. Managing investments on behalf of clients

D. Providing legal advice

4. Which of the following best describes insurance services?

A. Providing investment advice

B. Protecting against financial loss from risks such as accidents or illness

C. Offering transportation services

D. Manufacturing goods

5. Which of the following is a key service offered by credit card companies?

A. Provide retirement planning

B. Offer short-term, revolving credit

C. Underwrite initial public offerings (IPOs)

D. Provide long-term business loans

SECTION 1.2: FINANCIAL SERVICES AND ECONOMIC AND TECHNOLOGICAL ENVIRONMENT

The interplay between financial services and the economic and technological environment is pivotal in shaping modern economies. Financial services encompass a range of activities and products that manage money, including banking, investment, insurance, and payment systems. These services are deeply influenced by both economic conditions and technological advancements, which together determine the efficiency, accessibility, and innovation within the financial sector.

1.2.1 Financial Services and Economic Environment

The growth of financial services in a country needs proper economic environment. This consists of various economic factors such as:

Favourable Economic System: Financial Services provide financial assistance according to the requirements of different business activities. A business may function under different forms of organizations, such as sole trader, partnership firm, joint stock companies (or) by Multinational Corporation etc. It may also be undertaken by the government by way of public sector enterprises.

Economic Laws: Some of the economic laws are:

- Industries and Regulation Act for promoting proper investment.
- Companies Act for regulating proper management of companies
- Securities (contract and regulation) Act for streamlining transactions in stock exchange.
- Consumer Protection Act to safeguard the interests of consumers.
- Foreign Exchange Regulation Act for regulating foreign investment, which is now called Foreign Exchange Management Act (FEMA).

Economic Policies: In economy policy, we deal with aspects connected with improving the economic conditions of the country. The government will adopt such policies which promote investment, production, employment, foreign trade, economic growth, etc. For their purpose, the policy will be aimed at encouraging investment, both from domestic and foreign country. Increase of production in agriculture, industry and service sectors has to be taken up through proper pricing policy, procurement policy, allowance and subsidies, tax concessions, etc.

Economic Planning: In economic planning, accounting decides a particular course (or) path for its development. Planning fixes the rate of growth of the economy and accordingly links all the physical, fiscal and monetary resources to achieve the desired growth. The purpose of economic planning is to achieve rapid economic growth in all the sectors of the economy so that the people in the country experience a higher standard of living.

Economic Condition: Financial Services can be active only under favourable economic conditions. If there is depression with falling prices and closing down of production, financial services cannot experience more scope. So, a controlled inflation with more scope for investment and production will be ideal for the expansion of financial services.

1.2.2 Macro-Economic Aggregates and Policies

Here, we deal with various macro-economic factors which not only influence the economic condition of the country but also the working of financial services in the country. Economic factors at the national level, influencing the economic condition of the country can be stated as macro-economic aggregates. There are

1. Savings of the economy: In most of the developed countries, savings of the people form a major part of investment in the country. Savings can be there only when the income level of the people is higher and the people are living above the poverty level. In our country, savings are on an average only 9% of the total gross domestic product. As against this, in developed countries, they are nearly 28 to 30% of GDP. For example, the purchase of jewels in the rural economy. Hence, the financial services in our country are unable to play a major role due to poor savings.

2. Investment: The growth of the economy depends on the extent of investment made in the country. Investments must generate more production and they should promote a balanced growth of all the sectors in the economy. Thus, the more production in agriculture will create conditions for growth in industrial sector and services sector. Investment can be done both by public and private sectors. Investment as a percentage

of GDP should be sufficient so that the desired growth is achieved in all the sectors of the economy.

3. Economic growth: The increase in physical production in all the three sectors of the economy namely agriculture, industry and service is referred as economic growth. An increase in economic growth need not bring an increase in economic development. Because, the increased production may be consumed by the increased population.

4. Capital formation: When a company earns profits, it may plough back a part of its profits in the business which expands its capital. In this way, capital formation takes place for capital formation, a reduction in consumption is very essential. Financial services can play a major role by attracting the savings (or) the profit earned by the companies for a beneficial investment.

5. Capital-output ratio: The amount of capital required for an output is dealt in the capital-output ratio. The significance of this ratio is the quantum of capital needed for generating the required output with more technology. Lesser capital is utilized and more output is obtained with a higher amount of investment, the capital-output ratio is bound to bring in more benefits to the economy. The difference between an under developed and a developed country in this – a developed country consumers less capital but brings out more output, while an under developed country consumers more capital and turns out lesser output due to poor technology. We can very well experience this in our agriculture.

6. Population Growth: Increase in population may retard the economic growth of a country. But unfortunately, the productive force is of a higher percentage. Of late, the export of services is gaining ground and in this context, India has earned more than 15% of its expert earnings in the IT industry by exporting software financial services require more human touch and it is here that a trained person in financial service contributors more to the economy.

7. Growth of Foreign Trade: Export forms a major part of any developed economy most of the countries which have developed rapidly have given due importance to

foreign trade. The promotion of foreign trade requires the active support of financial services. Banks provide export finance. Factoring and forfeiting companies finance the exporter. In this way, every aspect of financial service promotes foreign trade which in turn plays a crucial role in the development of the economy.

8. Balance of Payments: The receipts and payments of a country from abroad are represented by the balance of payments statement. If the receipts are more and the payment is less, the country experiences a favourable balance of payments position. But sometimes, it may face a reverse situation, with more payments and less receipts, leading to unfavourable balance of payments. Thus the financial services can act as a bridge between the foreign investor on the one hand and the domestic producer on the other.

9. Foreign Debt: Financial Services helps the economy in mobilizing foreign debt. Such debts can be obtained in the global financial market at a competitive rate of interest. Normally, the credit rating of the country is taken into consideration before extending any foreign loan. Hence, raising foreign debts at a competitive rate of interest and putting them for proper use is another important factor and the financial services ensure that the returns commensurate with the interest rate on the foreign debts.

10. Exchange Rate Stability: When a country continuously borrows in the foreign market followed by heavy imports, then it will experience a decline in its currency value in relation to foreign currency. For example, If India has an exchange rate of 1 US Dollar = Rs.48/-, after the imports and foreign debts, its exchange rate may slide to 1 US Dollar = Rs. 60/-. This slide will affect India, as we have to pay more for our debts which are now 25% more than what they were at the time of our borrowing.

11. Employment Level: Another Marco economic aggregate influenced by financial services is the level of employment. With more financial services such as leasing, hire purchase finance, housing finance, insurance etc., the level of employment opportunity in the country is bound to increase. This will create more demand and other industries will also expand. Thus, the country can reach the level of full employment.

12. Capital Inflow: The capital market in the country can attract more capital from abroad, leading to capital inflow. This will take place only when the return on capital much higher or the interest rate offered is higher than what is prevailing in the domestic country.

13. Per Capita Income as an indicator of Economic Development: When the national income of the country increase due to increased production and services, the benefits goes to the population in the form as per capita income which is an indicator of the economic development of the country. Financial services can increase the per capita income by providing various types of loans and encouraging self-employment schemes.

1.2.3 Financial Services and Technological Environment

- **Applications of blockchain in financial services:**

A blockchain is a digitally distributed, decentralised and immutable public ledger that facilitates the process of recording transactions and tracking assets. Using this technology, individuals can enable secured transactions among themselves, without involving any intermediaries. The blockchain network shares a single version of the truth that enables users to access all the end-to-end transaction details, ensuring transparency and making it ubiquitous.

Existing blockchain use cases in financial services: Blockchain technology has already seen multiple use cases in the financial services space and is revolutionising different processes and value chains. A few such use cases have been highlighted below.

Banking: The use of blockchain increases transparency, and allows easy tracking, reporting and validation. This helps banks to complete the bank guarantees process in a day, as opposed to the traditional turnaround time of up to a month.

Payments: Cross-border payments through blockchain have been enabled by a US-based technology firm. Real-time faster cross-border payments are offered at lower cost by the firm through the use of their blockchain-powered cross border bridge.

Lending: A blockchain technology-based company was recently granted approval by the Reserve Bank of India (RBI) to test its blockchain-based micro, small and medium enterprises (MSMEs) lending product in the regulatory sandbox. The company has built a regulatory-compliant co-lending product enabled with blockchain for MSME loans to deliver credit with automated processes.

Insurance: A Russia-based FinTech is currently offering the first peer-to-peer (P2P) insurance coverage service using blockchain technology. The product allows for an insurance policy that would be managed by a group of people. The group members will be able to define the insurance policy, premiums, claims and reimbursement rules.

- **Data storage, computation and edge computing:**

An enormous amount of data is produced every day around the world. It is estimated that in 2022, we would produce 97 ZB of data.19. This will only increase as utility appliances like fridges, televisions, ovens and lights are being connected via sensors through IoT. Using IoT devices provides real-time data which can be used to derive actionable insights when coupled with AI and cloud technology.

The rapid increase in the amount of data being generated has outpaced the developments in data storage and transmission infrastructure. Earlier, the data collected was sent to either a centralized data repository or uploaded to the cloud for processing. However, the large amount of data being generated daily has led to the need for greater computational capacity and better storage and bandwidth. Also, data generated by businesses is processed more efficiently if it is closer to the source producing it. An upcoming alternative to this centralized model of data sharing is edge computing. This technology comprises a distributed computing framework, using which data is analyzed closer to its source (e.g. intelligent bots on a factory floor, smartphones, smart watches, etc.), and processing power is moved closer to the source of the data rather than a server situated far away. Edge computing has the potential to considerably reduce latency as compared to the traditional centralized data-sharing models. Reduced latency would result in faster data analysis, leading to better insights and improved customer experience.

- **Introduction to quantum computing:**

The effects and advantages of implementing quantum computing are far-reaching in multiple industries. This technology has the potential to impact industry verticals such as healthcare, finance, commerce, communications, security, cyber security and cryptography, energy, space exploration, and numerous other disciplines. Any industry where the usage of data is inherent to its operation will have a significant impact through quantum computing. The global market for quantum computing is expected to grow from USD 472 million in 2021 to USD 1,765 million by 2026, at a CAGR of 30.2%.

With the vast amount of data generated by the financial services market, activities surrounding financial services – like portfolio optimization or pricing – can benefit by using quantum computing, which can help in assessing multiple outcomes through algorithms. When we consider the capital markets, it is generally the buyers (hedge funds, private equity and venture capitalists) and incumbents (banks) that deal with highly complex problems. Consequently, these are currently investing in quantum computing, apart from the technology majors. Financial services players have often used physics to address and resolve some of the key challenges such as price formulation, price dynamics and market instabilities. Similarly, the first movers using emerging quantum computing technology could deal with problems like constrained optimization and uncertainty.

This could help in the calculations of dynamic arbitrages, better compliance, improved customer experience through behavioural data analysis and improved reaction time to market volatility.

1.2.4 Considerations for Policy makers and Regulators

As the emerging technologies continue to see traction and global adoption, policymakers and regulators need to shape this adoption and usage to enable growth and safeguard against possible risks. The policies, interventions and guardrails that can

foster the growth of FinTech models and emerging technologies in a responsible way should fulfil the following major goals:

- Reforms must enable the building of a supportive infrastructure to promote services by encouraging the use and adoption of such infrastructure
- Rules and guidelines must be formed and implemented to monitor the use of technology by market participants to ensure that no segment is being exploited
- Policies to protect vulnerable sections of the society and at-risk customers as well as to prevent money laundering and terrorism funding are also needed.

Policy interventions:

1. **Data-sharing guidelines:** Owing to the vast amounts of data being generated globally with more individuals and companies opting for digitalization, organizations and governments have realized that this technological transformation can be leveraged to provide better quality targeted services and products. However, in order to be scalable, this transformation requires adequate protection rules and data privacy laws to ensure that personal and business data are used responsibly and enforce trust among the stakeholders. The regulatory aspects can be facilitated by encouraging the adoption of emerging technologies, such as blockchain and quantum computing. Adopting blockchain as a solution guarantees the fidelity and security of data records and enables trust with no external aid or third-party dependencies. Blockchain adoption and usage by financial services firms may be deliberated upon by policymakers.
2. **Fiscal incentives and policy environments:** Fiscal incentives and policy environments that promote the development of the FinTech industry and innovation can play a critical role in FinTech growth. The Blockchain District in Hyderabad, for instance, will house all major blockchain technology companies, a huge incubator and a world-class facility for promoting research, innovation and industry collaboration.26 It will provide land for companies at a subsidized rate,

capital funding for research and development, and regulatory and policy support to start-ups.27

3. **Cyber security:** The advent of emerging technologies has also increased the scope for new types of financial frauds which require unconventional cyber security approaches. With FinTech, cyber threats have become more expensive and riskier owing to the vast data stored online. To minimize risk and fraud, data needs to be desensitized and tokenized. Data desensitization is the process of deforming, bleaching or masking information that is sensitive in nature, in order to safeguard business-sensitive and private data. Likewise, data tokenization is the method of swapping the non-sensitive data element in place of the actual data element. This form of substitution is done via a token, which holds no underlying, extrinsic or other value. For example, as per the RBI's tokenization regulations, e-commerce platforms would have to delete card-on-file information.30

4. **Digital financial literacy and capacity building:** To empower users and prevent massive cyber and financial frauds, it is necessary to promote digital financial awareness and literacy to establish trust, safety and security to encourage the adoption of Fintech-supported financial services. While adding disclaimers before advertisements and on websites of financial services players is a mandate, the Government can insist on clearer communication and delivery of financial education to users of a financial service by emerging players (for instance, those players providing services related to NFTs, DeFi and the metaverse). This can be an efficient corporate social responsibility mandate that will reduce asymmetric information in the market without the extensive use of public resources.

5. **Regulatory and policy framework for innovation:** As emerging technology adoption brings about a change in the financial services sector, it has become necessary for pertinent legal and regulatory framework be setup to prevent and identify obstacles and tackle any new risks which might arise. These frameworks should further ensure that consumer rights and data are protected. Many regulators around the world have developed various approaches – such as

innovation offices, test-and-learn approaches and regulatory sandboxes to facilitate safe experimentation and innovation.

6. **Safeguarding consumers' interests:** Effective consumer protection guidelines are necessary to build trust in order to have a positive impact on adoption. This can be done by providing transparency to consumers regarding the use of their data and how the services employed will impact them. Moreover, these guidelines will include rules that need to be put in place to prevent unfair market practices and appropriate complaint redressal mechanisms. The adoption of the technologies mentioned above by the financial services players needs to be accompanied by clear mandates and guidelines about how these changes will impact the pre-existing service provision as well as the customer–company relationship. In case of a major overhaul in the system and relationship, it becomes necessary that adequate steps are taken to ensure that these changes are clearly communicated to the consumers. This needs to be accompanied by a set of instructions about best practices and the code of conduct to be followed by either party, or a proper redressal mechanism.

1.2.5 Players in Financial Services Sector

- Financial Service Sector comes under the tertiary sector is which banks play a major role. For the growth of financial services, banks are led by the central bank of the country followed by commercial banks, co-operation banks, development banks, foreign banks etc.
- **Hire purchase financier** is also a player in the financial service sector as he enables the consumer to buy the product on credit basis.
- **Leasing companies** through financial and operating lease ensure the acquiring of assets by producers on a long-term basis at a reasonable charge.
- **Factoring** enables the saver to obtain 80% value of sales from the financial companies undertaking factoring services.

- **Underwriters** and merchant bankers are additional players who promote not only companies but also ensure dynamic activity in the capital market.
- **Book-builders** help companies in allotting shares to different categories of investors.
- **Mutual funds** ensure investment by the public and also ensure tax relief to the investor.
- **Credit cards**, another important player in the financial services, ensure the circulation of plastic money and enable purchase on credit by the consumer.
- **Credit rating companies** play an important role by giving different credit ratings to companies to mobilize public deposits.
- **Housing finance** companies and insurance companies also promote investment in the economy as they also form a part of the players in the financial services.
- **Asset liability management** company enables mutual funds to undertake proper investment in different types of economy.
- **Finance companies** in general and also as a part of non-banking finance companies provide additional funds to the above players so that there is more activity in the economy.

Let's Sum Up

Learners, in this section we have seen the financial services sector, which includes banking, investment, insurance, and payment systems, is significantly influenced by both economic conditions and technological advancements. The Economic environment includes macroeconomic indicators, regulatory framework, market conditions, and global economic trends. The technological environment includes digitalization, fintech innovation, data analytics and AI, cybersecurity, and payment technologies. Understanding these dynamics is essential for financial institutions to navigate challenges and seize opportunities in a rapidly evolving environment.

Check Your Progress

1. **Which of the following is a primary component of the economic environment that affects financial services?**
   - A. Cloud Computing
   - B. GDP Growth
   - C. Blockchain technology
   - D. Mobile banking
2. **What is the role of regulatory frameworks in the financial services sector?**
   - A. To limit the use of technology
   - B. To ensure stability and protect consumers
   - C. To decrease competition
   - D. To promote inflation
3. **________________is a digitally distributed, decentralised and immutable public ledger that facilitates the process of recording transactions and tracking assets.**
   - A. Digital Wallets
   - B. Blockchain Technology
   - C. Cloud Computing
   - D. Quantum Computing
4. **Which of the following technologies is essential for protecting financial data from cyber threats?**
   - A. Automated Teller Machines (ATMs)
   - B. Cybersecurity measures
   - C. Paper-based ledgers
   - D. Over-the-counter transactions
5. **How do global economic trends affect financial services?**
   - A. They have no impact
   - B. They only affect local markets
   - C. They influence international trade, investment and market dynamics
   - D. They only concern regulatory bodies

SECTION 1.3: Reserve Bank of India

1.3.1 Reserve Bank of India – An Introduction

The attempts to establish a central bank in India took a definite shape, when in 1927a bill was introduced in the Indian legislative assembly to establish a gold standard currency for British India and constitute a reserve bank of India. Thereafter various attempts were made thus, the reserve bank of India Act was passed in 1934 and the bank began functioning from 1st April 1935. Later was decided to nationalize the bank and the reserve bank of India transfer to public ownership) act was passed in September 1948 under which the ownership of the bank was passed into the hands of the government of India with effect from 1st January 1949.

1.3.2 Functions of Reserve Bank of India

I. Traditional Functions

✓ **Monopoly of note issue:**

In terms of section 22 of the reserve bank of India Act, the RBI has been given the statutory function of note issue on a monopoly basis. The note issue in India was originally based upon "proportional reserve system".

When it's become difficult to maintain the reserve proportionately, it was replaced by "minimum reserve system".

✓ **Banker to the Government**

The RBI acts as banker to the government under section 20 of RBI Act. Section 21 provides that government should entrust its money remittance, exchange and banking transactions in India to RBI. Under section 21 A RBI has to conduct similar transactions for state governments also.RBI earns no income by conducting those functions but earns commissions for managing the government's public debt.

✓ **Agent and Adviser to the Government**

The reserve bank acts as the banker agent and adviser to Government of India:

1. It maintains and operates government deposits.
2. It collects and makes payments on behalf of the government.

3. It helps the government to float new loans and manages the public debt.
4. It sells for the central Government treasury bills of 91 days duration.
5. It provides development finance to the government for carrying out five year plans.

✓ **Banker To The Banks**

The RBI keeps the cash a reserve of all the scheduled banks is, therefore, known as the Reserve bank. The scheduled banks can borrow in times to need form RBI. The RBI acts not only as the bankers' bank but also the lender of the last resort by providing rediscount facilities to scheduled banks.

✓ **Acts as the Clearing House of The Country**

In India RBI Acts as the clearing house for settlement of banking transactions. This function of clearing house enables the other banks to settle their interbank claims easily. Further it facilitates the settlement economically. Where the RBI has no offices of its own, the function of clearing house is carried out in the premises of the state bank of India. The entire clearing house operations carried on by RBI is computerized.

II. Promotional Functions

✓ **Promotional of banking habit and expansion**

The RBI institutionalizes saving through the promotion of banking habit and expansion of the banking system territorially and functionally. Accordingly RBI has set up deposits insurance corporation in 1962, unit trust of India in 1964, the IDBI in 1964, the Agricultural refinance corporation in 1963, industrial reconstruction corporation of India in 1972, NABARD in 1982 and the national housing bank in 1988,etc.

✓ **Exchange control and Custodian of Foreign Reserve**

RBI has the responsibility of maintaining fixed exchange rates with all member countries of IMF. For this, RBI has centralized all foreign exchange reserves (FOREX). RBI functions as custodian of nation's foreign exchange reserves. It has to maintain external value of Rupee. RBI achieves this aim through appropriate monetary fiscal and trade policies and exchange control.

✓ **Helping the co-operative sector**

RBI extends indirect financing to State Co-operative Banks thereby connects the co-operative sector with the main banking system of the country. The finance is mostly is routed through NABARD. This way the financial need of agricultural sector is taken care of by RBI.

III. Supervisory Functions

- ✓ **Granting license to banks.**

The RBI grants licence to the banks, which like to commence their business in India. Licenses are also required to open new branches or closure of branches. With this power RBI can ensure avoidance of unnecessary competitions among banks in particular location evenly growth of bank in different regions, adequate banking facility to various regions etc, This power also help RBI to weed out undesirable people from starting banking business.

- ✓ **Implementation of deposit insurance scheme.**

RBI implements the deposits insurance schemed for the benefits of bank depositors. This supervisory function has improved the standard of banking in India due to this confidence building exercise. Under this system, deposits up to Rs.1.00 lakh with the bank branch is guaranteed for payment. Deposits with the banking system alone is covered under the scheme.

- ✓ **Periodical review of review of the work of commercial banks.**

The RBI periodically reviews the work done by commercial banks. It takes suitable steps to enhance the efficiency of the banks and make various policy changes and implement programmes for the well-being of the nation and for improving the banking system as a whole.

Controls The Non-Banking Financial Corporations

RBI Issues necessary Directions to The non-banking financial corporations and conducts inspections through which it exercise control over such institutions. Deposit taking NBFCs require permission from RBI for their operations.

Let's Sum Up

Learners, in this section we have seen about Reserve Bank of India (RBI) which is the central banking institution of India, responsible for regulating the country’s monetary and financial system. Established on April 1, 1935, under the Reserve Bank of India Act, 1934, the RBI plays a crucial role in the Indian economy by managing monetary policy, issuing currency, and overseeing financial stability. The Reserve Bank of India is central to the functioning of India's economy, ensuring monetary stability, financial regulation, and the smooth operation of the financial system. By managing currency issuance, regulating financial institutions, overseeing foreign exchange, and promoting financial inclusion, the RBI plays a pivotal role in sustaining economic growth and maintaining public confidence in the financial system.

Check Your Progress

1. What is the primary role of the Reserve Bank of India (RBI)?

A. Regulating stock markets

B. Managing fiscal policy

C. Regulating and supervising the banking sector

D. Setting interest rates for loans

2. Which year was the Reserve Bank of India (RBI) established?

A. 1935

B. 1947

C. 1950

D. 1969

3. Who is the current Governor of the Reserve Bank of India (as of 2022)?

A. Raghuram Rajan

B. Urjit Patel

C. Shaktikanta Das

D. Viral Acharya

4. Which of the following is NOT a function of the Reserve Bank of India (RBI)?

A. Issuing currency notes

B. Formulating and implementing monetary policy

C. Regulating foreign exchange transactions

D. Managing agricultural subsidies

5. What is the highest decision-making body of the Reserve Bank of India?

A. Board of Governors

B. Monetary Policy Committee (MPC)

C. Executive Committee

D. Central Board of Directors

SECTION 1.4: COMMERCIAL BANK

1.4.1 Commercial Bank - Meaning

A commercial bank is a business organization which deals in money i.e., borrowing and lending of money. In this borrowing and lending of money it makes profit. It comprises a huge portion of the country’s credit and banking institutions or bank are dealers in money like a trader of goods.

1.4.2 Functions of Commercial Bank

Commercial bank being the financial institution performs diverse types of functions. It satisfies the financial needs of the sectors such as agriculture, industry, trade, communication, etc. That means they play very significant role in a process of economic social needs.

The functions performed by banks are changing according to change in time and recently they are becoming customer centric and widening their functions.

I. Primary Functions of Commercial Banks

Commercial Banks performs various primary functions some of them are given below,

1. **Accepting Deposits**:

Commercial bank accepts various types of deposits from public especially from its clients. It includes saving account deposits, recurring account deposits, fixed deposits, etc. These deposits are payable after a certain time period.

2. **Loans and Advances**:

The commercial banks provide loans and advances of various forms. It includes an overdraft facility, cash credit, bill discounting, etc. They also give demand and demand and term loans to all types of clients against proper security.

3. **Credit creation**:

It is most significant function of the commercial banks. While sanctioning a loan to a customer, a bank does not provide cash to the borrower Instead it opens a deposit account from where the borrower can withdraw. In other words, while sanctioning a loan bank automatically creates de5posits. This is known as a credit creation from commercial bank.

II. Secondary Functions of Commercial Banks

Along with the primary functions each commercial bank has to perform several secondary functions too. It includes many agency functions or general utility functions. The secondary functions of commercial banks can be divided into agency functions and utility functions.

1. Agency Functions: Various agency functions of commercial banks are

- ✓ To collect and clear cheque, dividends and interest warrant.
- ✓ To make payment of rent, insurance premium, etc.
- ✓ To deal in foreign exchange transactions.
- ✓ To purchase and sell securities.
- ✓ To act as trusty, attorney, correspondent and executor.
- ✓ To accept tax proceeds and tax returns.

2. General Utility Functions: The general utility functions of the commercial banks include

- ✓ To provide safety locker facility to customers.
- ✓ To provide money transfer facility.

- ✓ To issue traveler's cheque.
- ✓ To act as referees.
- ✓ To accept various bills for payment e.g. phone bills, gas bills, water bills, etc.
- ✓ To provide merchant banking facility.
- ✓ To provide various cards such as credit cards, debit cards, Smart cards, etc.

***III.* Modern functions**

✓ **Home banking**

Instead of going to the bank for withdrawal of money or for depositing of cheques, a customer can do his banking business by sitting at home.

✓ **Green card**

In India, credit card facility is given to the farmers by issue of green card to them. This will enable them to buy all their inputs by using the green card.

✓ **Factoring**

Commercial banks in India are undertaking factoring business. Under this, the bills drawn by customers on the buyer will be handed over to the bank for collection.

✓ **Mutual funds**

To enable the customers to avail the benefit of investments, banks in India have started mutual funds. The savings of the customers are invested in mutual funds by purchase of units.

✓ **Electronic Clearing System (ECS)**

The telephone charges are being paid through this system. The banks are connected to the telephone department through a network by which, the telephone charges of the customers are paid.

✓ **E-banking**

E-banking refers to the electronic banking; where in the entire operations are done by the customer through his computer system by using a code, which maintains secrecy of transaction.

Let's Sum Up

Learner, in this we have seen that commercial banks are financial institutions that provide a range of services including accepting deposits, offering loans, and facilitating

payment and transaction services. They play a crucial role in the economy by supporting both personal and business financial activities. Commercial banks are essential to the financial system, serving as intermediaries between savers and borrowers, facilitating payments, and providing financial services and advice. By supporting both personal and business financial activities, commercial banks contribute significantly to economic stability and growth.

Check Your Progress

1. What is the primary function of commercial banks?

A. Issuing government bonds

B. Providing loans and accepting deposits

C. Managing investment portfolios

D. Underwriting insurance policies

2. Which of the following is NOT a service typically offered by commercial banks?

A. Mortgage lending

B. Investment management

C. Personal checking accounts

D. Business loans

3. What is the term used to describe the interest rate at which commercial banks borrow money from the central bank?

A. Prime rate

B. Federal funds rate

C. Discount rate

D. LIBOR rate

4. Which regulatory body oversees the operations of commercial banks in the United States?

A. Securities and Exchange Commission (SEC)

B. Federal Deposit Insurance Corporation (FDIC)

C. Federal Reserve System

D. Financial Industry Regulatory Authority (FINRA)

5. What is the term for the interest rate charged by commercial banks on loans to their most creditworthy customers?

A. Prime rate

B. LIBOR rate

C. Discount rate

D. Federal funds rate

SECTION 1.5: FINANCIAL INSTITUTIONS

1.5.1 Industrial Development Bank of India (IDBI) – History, objectives, functions, role of IDBI

History:

Industrial Development bank of India (IDBI) was constituted under Industrial Development bank of India Act, 1964 as a Development Financial Institution (DFI) and came into being as on July 01, 1964 as a wholly owned subsidiary of RBI. In 1976, the ownership of IDBI was transferred to the Government of India and it was made the principal financial institution for coordinating the activities of institutions engaged in financing, promoting and developing industry in India. It was regarded as a Public Financial Institution in terms of the provisions of Section 4A of the Companies Act, 1956. It continued to serve as a DFI for 40 years till the year 2004 when it was transformed into a Bank.

Objectives of IDBI:

The main objectives of IDBI are to serve as the apex institution for term finance for industry in India. Its objectives include:

- Co-ordination, regulation and supervision of the working of other financial institutions such as IFCI , ICICI, UTI, LIC, Commercial Banks and SFCs.
- Supplementing the resources of other financial institutions and thereby widening the scope of their assistance.

- Planning, promotion and development of key industries and diversifications of industrial growth.
- Devising and enforcing a system of industrial growth that conforms to national priorities.

Functions of IDBI:

The IDBI has been established to perform the following functions-

- To grant loans and advances to IFCI, SFCs or any other financial institution by way of refinancing of loans granted by such institutions which are repayable within 25 years.
- To grant loans and advances to scheduled banks or state co-operative banks by way of refinancing of loans granted by such institutions which are repayable in 15 years.
- To grant loans and advances to IFCI, SFCs, other institutions, scheduled banks, state co-operative banks by way of refinancing of loans granted by such institution to industrial concerns for exports.
- To discount or re-discount bills of industrial concerns.
- To underwrite or to subscribe to shares or debentures of industrial concerns.
- To subscribe to or purchase stock, shares, bonds and debentures of other financial institutions.
- To grant line of credit or loans and advances to other financial institutions such as IFCI, SFCs, etc.
- To grant loans to any industrial concern.
- To guarantee deferred payment due from any industrial concern.
- To guarantee loans raised by industrial concerns in the market or from institutions.
- To provide consultancy and merchant banking services in or outside India.
- To provide technical, legal, marketing and administrative assistance to any industrial concern or person for promotion, management or expansion of any industry.

- Planning, promoting and developing industries to fill up gaps in the industrial structure in India.
- To act as trustee for the holders of debentures or other securities.

Role of IDBI:

- As an apex development bank, the IDBI's major role is to co-ordinate the activities of other development banks and term-financing institutions in the capital market of the country.
- Providing technical and administrative assistance for promotion, management and expansion of industry thus performing promotional and development functions.
- Direct Assistance*:* The IDBI grants loans and advances to industrial concerns. The bank guarantees loans raised by industrial concerns in the open market from the State Co-operative Banks, the Scheduled Banks, the Industrial Finance Corporation of India (IFCI) and other 'notified' financial institutions.
- Indirect Assistance*:* Providing refinancing facilities to the IFCI, SFCs and other financial institutions approved by the government. IDBI subscribes to the shares and bonds of the financial institutions and thereby provide supplementary resources.
- Coordinating the activities of financial institutions for the promotion and development of industries.
- IDBI is the leader, coordinator and innovator in the field of industrial financing in our country. Its major activity is confined to financing, developmental, co-ordination and promotional functions.
- Planning, promoting and developing industries with a view to fill the gaps in the industrial structure by conceiving, preparing and floating new projects.

1.5.2 Industrial Credit and Investment Corporation of India (ICICI) – History, objectives, functions, services of ICICI

History:

Industrial Credit and Investment Corporation of India was established as a joint stock company in the private sector in 1955. Its share capital was contributed by banks, insurance companies and foreign institutions including the World Bank. Its major shareholders now are Unit Trust of India, Life Insurance Corporation of India and General Insurance Corporation and its subsidiaries. They together hold approximately 50% of the paid up share capital of ICICI.

Objectives of ICICI:

The major objective of the ICICI was to meet the needs of the industry for permanent and long term funds in the private sector. In general, the major objectives of the Corporation are:

- To assist in the formation, expansion and modernization of industrial units in the private sector;
- To stimulate and promote the participation of private capital (both Indian and foreign) in such industrial units;
- To furnish technical and managerial aid so as to increase production and expand employment opportunities;
- To assist in the development of the capital market through its underwriting activities.

FUNCTIONS OF THE ICICI

The primary function of ICICI is to act as a channel for providing development finance to industry. In pursuit of its objectives of promoting industrial development, ICICI performs the following functions:-

- It provides medium and long-term loans in Indian and foreign currency for importing capital equipment and technical services. Loans sanctioned generally go towards purchase of fixed assets like land, building and machinery;
- It subscribes to new issues of shares, generally by underwriting them;
- It guarantees loans raised from private sources including deferred payment;
- It directly subscribes to shares and debentures;
- It provides technical and managerial assistance to industrial units;

- It provides assets on lease to industrial concerns. In other words, assets are owned by ICICI but allowed to be used by industrial concerns for a consideration called lease rent.
- It provides project consultancy services to industrial units for new projects.
- It provides merchant banking services.

Services of ICICI

1. Project Finance:

The project finance is provided to industries for the cost of establishment, modernization or expansion of manufacturing and processing activities in the form of rupee and foreign loans, underwriting, subscription to shares and debentures and guarantees to supply of equipment and foreign donors. The rupee loan is given for the purchase of equipment and machinery, construction and preliminary expenses. The foreign currency loans are provided for the purchase of imported capital equipment.

2. Leasing:

The leasing operations of the ICICI commenced in 1983. Leasing assistance is given for computerization, modernization/replacement, equipment of energy conservation, export orientation, pollution control etc.

3. Project Advisory Services:

The Project advisory services are provided to the Central and State Governments and public sector and private sector companies. Advice to the governments is provided on policy reforms and on value chain analysis and to private sector companies on strategic management.

4. Facilities for Non-resident Indians:

The information regarding on facilities and incentives given by the Government of India to the non-resident Indians for judicious investing in India are offered.

5. Provision of Foreign Currency Loans:

The ICICI has a provision of foreign currency loans and advances to enable Indian Industrial concerns to secure essential capital goods from foreign countries.

6. Other Institutions Promoted

✦ ICICI promoted the Housing Development Finance Corporation (HDFC) to provide long-term finance to individuals in middle and lower income groups, co-

operations, etc., for the construction and purchase on ownership basis of residential houses all over the country.

- Credit Rating Information Services of India Ltd. (CRISIL) set up by ICICI in association with Unit Trust of India (UTI) to provide credit rating services to the corporate sector.

1.5.3 Industrial Finance Corporation of India (IFCI) – History, objectives, functions, management of IFCI

History:

Establishment of Industrial Finance Corporation of India

In 1948, the Government of India set up Industrial Finance Corporation of India (I.F.C.I) with a view of providing medium and long term finance to industries.

The Industrial Finance Corporation started with the authorized share capital of Rs. 10 crores divided into 20,000 share of Rs. 5,000 each. It can also issue bonds up to five times of its paid up capital. The Corporation is authorized to borrow from the Reserve Bank of India, the Central Government and the World Bank, in order to increase its resources.

Objectives of IFCI

The primary role of IFCI is to provide 'direct financial assistance' on medium and long term basis to industrial projects in the corporate and co-operative sectors. Over the years, the scope of activities of the corporation has widened. The objectives of the corporation are stated below.

- ✓ To provide long and medium-term credit to industrial concerns engaged in manufacturing, mining, shipping and electricity generation and distribution.
- ✓ The period of credit can be as long as 25 years and should not exceed that period;
- ✓ To grant credit to a single concern up to a maximum amount of rupees one crore. This limit can be exceeded with the permission of the government under certain circumstances;
- ✓ Guarantee loans and deferred payments;

- ✓ Underwrite and directly subscribe to shares and debentures issued by companies;
- ✓ Assist in setting up new projects as well as in modernization of existing industrial concerns in medium and large scale sector;
- ✓ Assist projects under co-operatives and in backward areas.

Functions or services of IFCI

- ✓ Granting loans and advances for the establishment, expansion, diversification and modernization of industries in corporate and co-operative sectors.
- ✓ Guaranteeing loans raised by industrial concerns in the capital market, both in rupees and foreign currencies.
- ✓ Subscribing or underwriting the issue of shares and debentures by industries. Such investment can be held up to 7 years.
- ✓ Guaranteeing credit purchase of capital goods, imported as well as purchased within the country.
- ✓ Providing assistance, under the soft loans scheme, to selected industries such as cement, cotton textiles, jute, engineering goods, etc.
- ✓ Providing technical, legal, marketing and administrative assistance to any industrial concern for the promotion, management and expansion of the industrial concern.
- ✓ Providing equipment (imported or indigenous) to the existing industrial concerns on lease under its 'equipment leasing scheme'.
- ✓ Procuring and reselling equipment to eligible existing industrial concerns in corporate or co-operative sectors.
- ✓ Rendering merchant banking services to industrial concerns.

Management of IFCI

The management consists of 12 directors to constitute the board and it is headed by a full time chairman. The board has representations from IDBI, Central Government Scheduled bank, Co-operative bank and Insurance companies.

- IFCI is now a joint stock company owned and managed by the government has been vested with wide power over the corporation and it is expected to carry

out the policy set out by the government. The day – to –day management of the corporation is vested in a board of directors consisting of a whole time chairman and twelve directors.

- The chairman is appointed by the central government in consultation with the industrial development bank of India. Two directors and nominated by the central government four by the IDBI and the remaining six directors are elected by the shareholders other than the IDBI. The board of directors will act on business principals with due regard to the interests of trade, industry and general public.
- There is also a central committee comprising the chairman and four directors.

1.5.4 Industrial Reconstruction Corporation of India (IRCI) – History, functions, resources of IRCI

History:

The Industrial Reconstruction Corporation of India was established as a public limited company in April, 1971 under the control of Reserve Bank of India and the Central Government. The basic objective of this corporation is to assist rehabilitation of sick industrial units or rehabilitation of units likely to face closure, but showing promise of viability. The down fall of the units may be due to frequent strikes, mismanagement, shortage of raw materials, general recession etc. Their closure will result in unemployment and dislocation of productive activities. So, in order to protect them, the IRCI has been set up. This corporation aims at providing financial, technical or managerial assistance so that they can be put up again as viable units.

Functions:

While accomplishing its main objective, the corporation performs the following functions.

- Restructuring of the management.
- Providing technical and managerial guidance either through its own staff or by procuring the suitable personnel from the market.
- Helping in getting assistance from other banks and financial institutions and Government agencies.

- Restructuring the financial base of the assisted companies.
- Finding out viable solutions to the labour problems.
- Advising the management with regard to product mix and other allied matters.

Resources:

The corporation has an authorized capital of Rs. 25 crores out of which Rs.10 crores have been issued to and subscribed by IDBI, IFCLICICI, Life Insurance Corporation of India, State Bank of India and the 14 nationalized banks. The Corporation has received Rs. 10 crores from Govt, of India and has raised Rs. 11 crores by issuing bonds to the public.

It is managed by the board of directors whose members shall not be less than 9 and more than 15. Three directors are appointed by IDBI. It has also constituted an executive committee to consider the grant of restructuring loans up to the extent of Rs 5 lakhs in any single case. The repayments period varies from 4 to 12 years.

1.5.5 Life Insurance Corporation (LIC) – Introduction, objectives, role and functions, advantages and disadvantages of LIC

Introduction:

The LIC of India was set up under the LIC Act, 1956 under which the life insurance was nationalized. As a result, business of 243 insurance companies was taken over by LIC on 1-9- 1956.

It is basically an investment institution, in as much as the funds of policy holders are invested and dispersed over different classes of securities, industries and regions, to safeguard their maximum interest on long term basis. LIC is required to invest not less than 75% of its funds in Central and State Government securities, the government guaranteed marketable securities and in the socially-oriented sectors. At present, it is the largest institutional investor. It provides long term finance to industries. Besides, it extends resource support to other term lending institutions by way of subscription to their shares and bonds and also by way of term loans.

LIC which has entered into its 57th year has emerged as the world's largest insurance co. in terms of number of policies covered. The LIC's total coverage of policies including individual, group and social schemes has crossed the 11 crore.

Objectives of LIC of India:

The LIC was established with the following objectives:

- ✓ Spread life insurance widely and in particular to the rural areas, to the socially and economically backward claries with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost
- ✓ Maximization of mobilization of people's savings for nation building activities.
- ✓ Provide complete security and promote efficient service to the policy-holders at economic premium rates.
- ✓ Conduct business with utmost economy and with the full realization that the money belong to the policy holders.
- ✓ Act as trustees of the insured public in their individual and collective capacities.
- ✓ Meet the various life insurance needs of the community that would arise in the changing social and economic environment
- ✓ Involve all people working in the corporation to the best of their capability in furthering the interest of the insured public by providing efficient service with courtesy.

Role and functions of LIC:

- ✓ It collects the savings of the people through life policies and invests the fund in a variety of investments.
- ✓ It invests the funds in profitable investments so as to get good return. Hence the policy holders get benefits in the form of lower rates of premium and increased bonus. In short, LIC is answerable to the policy holders.
- ✓ It subscribes to the shares of companies and corporations. It is a major shareholder in a large number of blue chip companies.
- ✓ It provides direct loans to industries at a lower rate of interest. It is giving loans to industrial enterprises to the extent of 12% of its total commitment.

- ✓ It provides refinancing activities through SFCs in different states and other industrial loan giving institutions.
- ✓ It has provided indirect support to industry through subscriptions to shares and bonds of financial institutions such as IDBI, IFCI, ICICI, SFCs etc. at the time when they required initial capital. It also directly subscribed to the shares of Agricultural Refinance Corporation and SBI.
- ✓ It gives loans to those projects which are important for national economic welfare. The socially oriented projects such as electrification, sewage and water channelizing are given priority by the LIC.
- ✓ It nominates directors on the boards of companies in which it makes its investments.
- ✓ It gives housing loans at reasonable rates of interest.
- ✓ It acts as a link between the saving and the investing process. It generates the savings of the small savers, middle income group and the rich through several schemes.

Advantages of Life Insurance:

1) Life Insurance is not an Investment; Life Insurance is an Expense and not an Asset. It is an expense just like your health insurance to make sure in case of serious illness you are covered and not in a position to pay the costs of your illness leading to your life ending in a bad manner. Life Insurance makes sure that your dependents can lead a decent life economically despite your death. This is the main purpose and advantage of life insurance

2) Tax Advantage – A number of countries allow you to offset the premiums that you pay for your life insurance in your taxable income. Also the maturity amount that you get is also not taxable in a number of places. Insurance is widely used by financial advisors to reduce your tax burden.

3) Advantage of Term Insurance – While Insurance Companies sell a wide variety of insurance products like term, variable, universal insurance most are complex and intended to fleece customers. Term Insurance is the best life insurance product for its simplicity and cheapness. It gives you a lump sum amount in case of death and has no

clauses and conditions. Its very simple to understand and the cheapest insurance product as well.

4) Flexibility in Coverage – Life Insurance is supposed to cover you till the time you have enough of a corpus for your dependents. You can take life insurance for 5,10,15,20 years. This also depends on your age but you get the basic idea. Suppose you have $50,000 in savings and you need another $450,000 for your family to be comfortable in case of your death. If you save $50,000 every year then it means that you need 9 more years to get to your target. In that case you can take life insurance for 9 years

5) Government Regulation provides Safety – The government heavily regulates the insurance sector making sure that your insurance company has enough assets to cover your liability. This means that you have the peace of mind that in case of your death the money will be given out by the life insurance company and it does not go bankrupt. Governments make sure that insurance companies don't fail like banks. Even if they do their liabilities are taken over by the government.

6) Universal and Variable Life Insurance Advantages – While in my opinion both of these 2 types of insurance are a complete waste of time and money they offer the advantage in some specific niche cases. These offer the option of investment and insurance by giving you an interest in the cash value of your insurance. Variable insurance allows you to change the premiums on your life insurance. However, the complications of calculating mortality and investment in a hybrid product is beyond the intelligence of most people in my opinion and you are better staying away from these products.

Disadvantages of Life Insurance:

1) The Cons of a Life Insurance chosen carefully is almost negligible. However the d**isadvantage of Life Insurance arises when it is used as an investment product**. Insurance companies also promote these as people are uncomfortable in paying premiums on which returns are uncertain. They think that if you are paying for insurance you must get back something. This is because of the psychological makeup of humans where we underestimate the chances of our demise.

2) Buying Life Insurance when you have no Need – People buy insurance when they have no need for example an old woman buying life insurance. Also the example of buying life insurance for a very long time period till you are 80 years old. At that age you have no need since you would have no dependents and earning power as well.

3) Buying Complex Life Insurance Products like ULIPs, Endowment, Child Plans etc which give sub optimal returns – Millions of people every year buy insurance products without understanding it. Most of the complex products give suboptimal returns and have no suitability for the buyers. Agents frequently give bad advice to get more commissions. Companies also make more money by selling complex products which people don't understand.

4) Buying Expensive Policies – People have little clue and don't compare life insurance products even from the same provider. Sometimes they buy insurance policies which are far too expensive leading to heavy burden which is unnecessary.

1.5.6 Tamil Nadu Industrial Investment Corporation Limited (TIIC) – Introduction, functions, and schemes of TIIC

Introduction

TIIC as a State Level Financial Institution, offers long and medium term financial assistance to various industries including service sector in the following forms: Term Loans. Term Loan and Working Capital Term Loans under the Single Window Scheme. Special types of assistance like Bill Financing Scheme, etc.

The Tamil Nadu Industrial Investment Corporation Limited (TIIC), a government company incorporated under the Companies Act 1913 and continues to be a government company under the Companies Act, 1956 and 1913. The authorized share capital of the company is Rs.425 Crores and the paid up capital of the company is Rs.321 Crores.

Tamil Nadu Industrial Investment Corporation Ltd. [TIIC] is a premier State Financial Corporation established in the year 1949. TIIC fosters industrial development in Tamil Nadu by providing financial assistance to industries for purchase of land, machinery and construction of buildings. TIIC provides financial assistance at

competitive interest rates for setting up of new industrial units and for expansion / modernization / diversification of existing industries in Tamil Nadu. It also offers loan for service sector projects such as hotels, hospitals and tourism related projects.

While TIIC provides assistance to micro, small, medium and large enterprises, about 90% of the assistance goes to the micro, small and medium enterprises [MSME] sector. Of this, about 40% goes to first generation entrepreneurs. Thus, TIIC acts as a catalyst for industrial promotion within the State by creating a new generation of entrepreneurs.

Functions:

TIIC as a State Level Financial Institution, offers long and medium term financial assistance to various industries including service sector in the following forms:

- Term Loans
- Term Loan and Working Capital Term Loans under the Single Window Scheme.
- Special types of assistance like Bill Financing Scheme,.
- Lease financing for machinery / equipments
- Merchant banking & others financial services
- Soft loan

Schemes:

a) Scheme for economically backward entrepreneurs :

- Entrepreneurs Development Scheme (EDS) – New scheme for the economically weaker section entrepreneurs.

b) New Entrepreneur cum Enterprise Development Scheme (NEEDS):

Financial assistance under New Entrepreneur cum Enterprise Development Scheme (NEEDS) for Micro & Small Enterprises (MSEs) has been introduced by the State Government to enable educated youth to become first generation entrepreneurs. Financial assistance is provided through Banks / TIIC for eligible candidates under this scheme. Entrepreneurs are eligible for 25% capital subsidy and 3% interest subvention under the NEEDS.

C) Schemes for Manufacturing Enterprises:

- General Scheme for New and Expansion Project
- Micro/Small Enterprises Funding Scheme (MSEF)
- Single Window Scheme (SWS)
- Equipment Finance Scheme (EFS)
- Revised and Restructured Technology Upgradation Fund Scheme (RRTUF) for Textile Industry Working Capital Term Loan (WCTL) for Manufacturing/Processing Industries and Job Order Industries Scheme for takeover of high cost borrowers/Switchover Loan Scheme
- Funding of second hand machinery (Imported and Indigenous) “TIIC's Liquidity Stimulus Package” for easing difficulties of Micro, Small and Medium Sector Enterprises Solar Power Projects Scheme
- Corporate Loan Scheme

D) Schemes for Service Enterprises:

- Information Technology Scheme
- Hotels Scheme
- Hospital Scheme
- Commercial Complex / Convention Centre/Community and Marriage Halls
- Warehousing / Cold Storage
- Corporate Loan Scheme

✓ **Schemes for Power Generation**

- Wind Power Project (new¬ & used) Generator Loan

✓ Short Term assistance by way of Bill Finance Scheme to TANGEDCO suppliers TANTRANSCO contractors

- TWAD Contractors
- TNPL vendors

✓ Funding of Working Capital needs of Contractors of State Govt./State Govt. Agencies:

Contractors Credit Scheme

✓ SCHEMES FOR QUALIFIED PROFESSIONALS My Doctor Scheme

Doctor Plus Scheme

- ✓ TRANSPORT OPERATOR SCHEME Auto Rickshaw Loan
  - Tourist Cabs
  - Heavy Public Carriers (Lorries)
  - Omni Bus

1.5.7 Export and Import Bank (EXIM BANK) - Introduction, functions, and financing services of EXIM bank

Introduction:

Export-Import Bank of India (EXIM Bank) was set up by an Act of the Parliament "THE EXPORT-IMPORT BANK OF INDIA ACT, 1981" for providing financial assistance to exporters and importers, and for functioning as the principal financial institution for co-ordinating the working of institutions engaged in financing export and import of goods and services with a view to promoting the country's international trade and for matters connected therewith or incidental there to.

Functions:

1. Planning, promoting and developing exports and imports;
2. Providing technical, administrative and managerial assistance for promotion, management and expansion of exports.
3. Undertaking market and investment surveys and techno-economic studies related to development of exports of goods and services.
4. Financing exports and imports of capital equipment on lease basis
5. Financing to joint ventures in foreign countries
6. Undertakes merchant banking, underwriting of companies engaged in EXIM
7. Provides refinance facilities to commercial banks and financial institutions.

Financing services:

1. **Indian companies executing contract overseas:** The pre-shipment credit facility of the EXIM bank provides access to finance at manufacturing stage, enabling exporters to purchase raw materials and other input required for export production.
2. **For commercial banks:** The EXIM bank offers rediscounting facility to commercial banks, enabling to rediscount export bills of their SSI customers, with issuance not exceeding 90 days.
3. **Other facilities for Indian companies:** Indian companies financing multilateral funding agencies, executing with in India may avail of credit under financing for deemed export facility to meet cash flow deficits.
4. **For overseas entities:** It provides buyer's credit to overseas buyers for import of eligible goods from India on deferred payment terms. It extends lines of credit to overseas financial institutions, foreign government and other agencies enabling to on lend term loans to financing import of eligible goods from India.
5. **Export Services:** It offers a diverse range of information, advisory and support services to enable exporters to evaluate international risks, exploiting opportunities and improve competitiveness. Advises companies on regulatory clearances, joint ventures, suppliers, technology, etc

1.5.8 State Financial Corporation (SFCs) - Introduction, objectives and functions of SFC.

Introduction:

State Financial Corporation (SFC) is state level financial institutions, which play an important role in the development of small and medium enterprises. The SFCs will have a capital from Rs. 50 lakhs to Rs. 5 crores, which will be contributed by state government, scheduled banks, RBI and other financial institutions.

Objectives of SFCs:

The SFCs will provide long-term loans to small-scale industries and medium scale industries

- ✓ SFCs will promote tiny sector, village industries and cottage industries.

- ✓ SFCs will provide infrastructure facility by promoting industrial estates
- ✓ It will guarantee for the loan taken by small-scale industries in the market
- ✓ Modernization of small-scale industries will also be undertaken by SFC.
- ✓ The SFCs help in purchase of capital equipment on a deferred basis.
- ✓ In Tamil Nadu, the madras industries Investment Corporation was started as early as 1948 and it was the first state level finance corporation in whole of India. This has been renamed as ***Tamil Nadu industries investment corporation (TIIC)***

Apart from promoting small scale industries in Tamil Nadu. The promotion of various institutions is done by TIIC. These are.

- ✈ SIDCO: Small Industries Development Corporation.
- ✈ SIPCOT: Small Industries Promotion Corporation of Tamil Nadu.
- ✈ TANSI: Tamil Nadu Small Industries Corporation.
- ✈ ITCOT: industrial and technical consultancy organization of Tamil Nadu.

Besides, these are organization such as federation of small industries women entrepreneurs development programme etc.

<u>Functions of SFCs:</u>

A State Finance Corporation can transact the following types of business:

- ✓ Guaranteeing, on such terms and conditions as may be agreed upon, of loans raised by industrial concerns, which are repayable within a period not exceeding 20 years and are floated in public markets;
- ✓ Under writing the issue of stocks, shares, bonds or debentures by industrial concerns;
- ✓ The granting of loans or advances to , or Subscribing to the debentures of industrial concerns, repayable within a period not exceeding 20 years from the date on which they were granted or subscribed to, a the case may be;
- ✓ Guaranteeing deferred payments due from industrial concerns in connection with their purchases of capital goods within India. This power has been given under the Amendment Act of 1962;

- ✓ Subscribing the share capital of the borrower companies, in case they wish to raise additional capital; and
- ✓ Generally the doing of all such acts as may be incidental to, or consequential upon the exercise of its powers or the discharge of its duties under this Act.
- ✓ A state Finance Corporation can charge commission for the services rendered by it in connection with and types of business mentioned above. In case it has to retain any shares of debentures under an underwriting agreement under clause. Above, it must dispose of them as early as possible as but not later than 7 years from the date of acquisition.

1.5.9 State Industrial Development Corporations (SIDCs) - Introduction, objectives, functions and services of SIDCs.

Introduction:

In many state governments, for the promotion of small scale industries, a separate corporation has been set up which is known as small industries development corporation. They undertake all kinds of activities for the promotion of small scale industries. Right from the stage of installation, to the stage of commencing production, these corporations help small scale industries (SSI) in many ways. In short, they provide infrastructure facilities to small scale industries. Due to the assistance provided by SIDCO, many backward areas in most of the states have been developed. So, SIDCO has also been responsible in spreading the industrial activity throughout several states.

Objectives:

- ✓ To stimulate development of industries in the small-scale sector
- ✓ To provide infrastructure facilities like roads, drainage, electricity, water supply etc.
- ✓ To promote industrial estates
- ✓ To provide training facilities to the entrepreneur
- ✓ To promote skilled labor through the setting up of industrial training institutes

Functions and services:

- **Supplying scarce raw materials:**

Some of the scarce raw materials are procured by the corporation either from the domestic market or from abroad and are provided to the needy small-scale industries.

- **Providing marketing assistance:**

In order to provide an efficient marketing support to small-scale industries, the corporation has taken up various schemes.

- **Bills discounting assistance:**

When small-scale units supply goods to government departments, there is a delay in receiving payments. In such a situation, the bills drawn on government departments will be discounted by SIDC.

- **Export marketing assistance:**

To promote export marketing among the small-scale industries, SIDC has developed websites because of which it is able to display the products of the small-scale industries.

- **Promoting skill development centers:**

In an effort to supply skilled laborers to various small-scale industries, 'Skill Development Centers' are being set up in various industrial estates.

- **Promotion of women entrepreneurs:**

In order to promote women entrepreneurs, a separate industrial estate for women is being developed near Madras, where women entrepreneurs will be trained in various fields of small-scale industries.

- **Captive power plants:**

In order to provide uninterrupted and good quality power supply, SIDCO has taken up a plan to set up captive power plants in major industrial estates. It is now planning to set up these plants in 10 industrial estates.

Let's Sum Up

Learners, in this section we have seen financial institutions namely IDBI, ICICI, IFCI, IRCI, LIC, TIIC, EXIM BANK, SFC, and SIDC. They play

a crucial role in the economy by facilitating the flow of money, offering investment opportunities, managing risks, and promoting economic stability. Financial institutions are fundamental to the functioning of the economy, providing essential services that facilitate savings, investment, credit, and risk management. By efficiently allocating resources and supporting financial stability, these institutions contribute significantly to economic growth and development.

Check Your Progress

1. **What is the primary function of the Industrial Development Bank of India (IDBI)?**
   A. Providing Life Insurance
   B. Facilitating foreign trade
   C. Offering long-term finance for industrial development
   D. Managing pension funds
2. **Which institution was established as a development finance institution to provide project financing to Indian industries?**
   A. Life Insurance Corporation of India (LIC)
   B. Export-Import Bank of India (EXIM Bank)
   C. Industrial Credit and Investment Corporation of India (ICICI)
   D. State Financial Corporation (SFC)
3. **Life Insurance Corporation of India (LIC) is primarily involved in:**
   A. Financing industrial projects
   B. Providing life insurance and investment services
   C. Facilitating foreign trade
   D. Offering educational loans
4. **What is the primary objective of the Export-Import Bank of India (EXIM Bank)?**
   A. Providing housing loans
   B. Facilitating and promoting international trade

C. Offering life insurance policies

D. Managing pension funds

5. State Industrial Development Corporations (SIDCs) are established to:

A. Provide short-term consumer loans

B. Promote industrial development at the state level

C. Facilitate international trade

D. Offer health insurance

SECTION 1.6: NATIONAL STOCK EXCHANGE (NSE)

It is the India's largest stock exchange. The exchange operates on an electronic market that allows trades to be made on its automated system. The exchange was established in 1992 and has grown to be the country's largest securities exchange. NSE has created several software programs and interfaces to assist investors with researching and making transactions. Three of the largest market segments traded on the exchange include wholesale debt, capital market, and derivates.

The national stock exchange was set up by all India financial institutions and banks in November 1992. It started operations on july1, 1994 to provide country wide screen based online trading facilities to investors.

There is no trading floor and members make transactions through their computer terminals which are linked with the central computer at NSE.

National trade facilities though electronic clearing and settlement system are available to investors. NSE is a countrywide on ling trading system, conforming to international standard. A company with a minimum capital of Rs.10 crores is eligible for listing on the NSE.

Objectives of NSE:

The main objectives of NSE are as follows:

❖ To establish a nationwide trading facility for equities, debt instruments and hybrids.

- To facilitate equal access to investors all over the country through an appropriate communication network and to provide a fair, efficient and transparent securities market to investors using electronic trading systems.
- To enable shorter settlement cycles and book entry settlement system.
- To meet the current international standards of securities markets.

SECTION 1.7: NON-BANKING FINANCIAL COMPANIES (NBFCs)

1.7.1 Non-Banking Financial Companies (NBFCs) - Introduction, meaning, growth, classification and structure of NBFCs.

Introduction:

Non –banking financial companies (NBFCs) constitute an important segment of the financial system. NBFCs are financial intermediaries engaged primarily in the business of accepting deposits and delivering credit. They play an important role in channelizing the scare financial resources to capital formation. NBFCs supplement the role of the banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sector and to small local borrower.

Meaning:

A non –banking financial company (NBFC) is a company registered under the companies Act, 1956 and is engaged in the business of loan and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by government or local authorities or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agricultural activity, industrial activity, sales/purchase/contraction of immovable property.

According to reserve bank of India (Amendment act), 1997 a non – banking finance company means:

- A financial institution which is a company.
- A non – banking institution which is a company and which has as its principal business the receiving of deposits under any scheme of arrangement or in any other manner or lending in any manner.
- Such other non – banking institution or class of such institutions as the bank may with the previous approval of the central government specify.

Growth of NBFC:

NBFCs in India have existed since long. They came into limelight in the second half of the 1980 and in the first half of the 1990s.

NBFCs flourished during the stock market boom of the early 1990. In the initial year of liberalization they not only became prominent in a wide range of activities but they outpaced banks in deposit raising owing to their customized services.

Total asset/liabilities of NBFCs grew at an average annual rate of 36.7 % during the 1990 (1991-98) as compared to 20.9 % during the 1980s (1981-91). The growing importance of this segment and the surfacing of some scams compelled the RBI to increase regulatory attention.

As on 30 June 2006, the total number of NBFCs registered with reserve bank were 13,041 of which 428 were public deposit accepting.

Types / classification of NBFC:

1. Equipment leasing company (ELC): Carrying on the activity of leasing of equipment.

2. Hire Purchase finance company (HPFC): Carrying hire purchase (or) financing of such transactions.

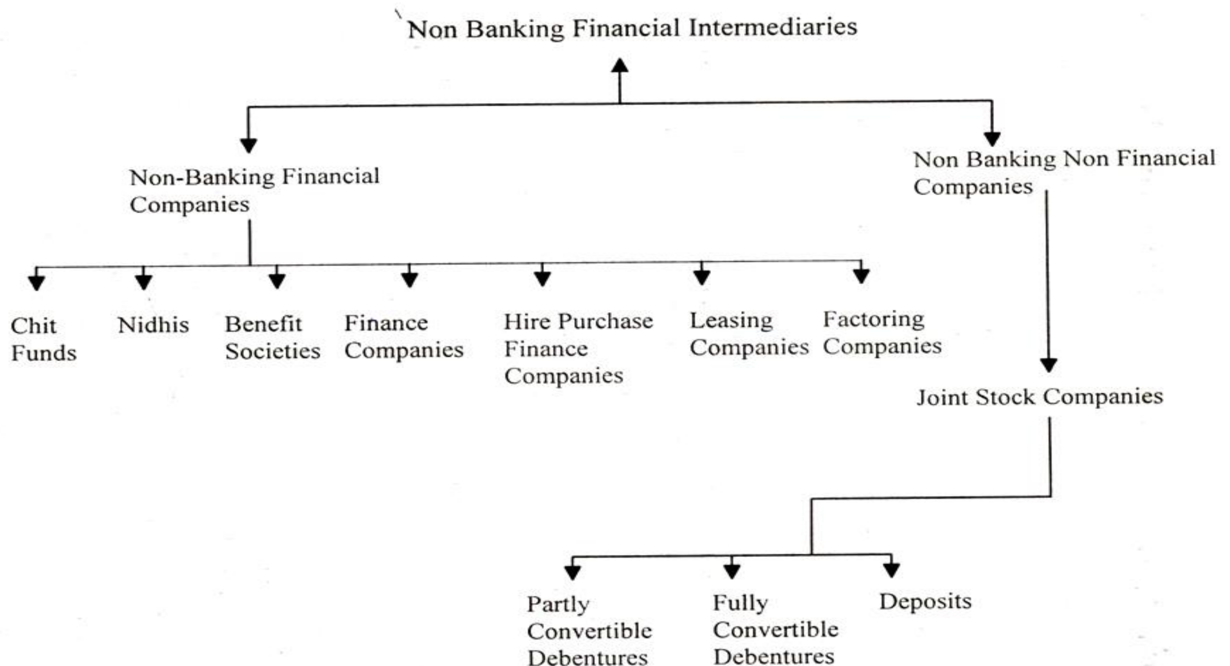
3. Housing finance company (HFC).

4. Investment Company (IC): Carrying the business of acquisition of securities.

5. Loan Company (LC): Financing by making loans and advances.

6. Mutual Benefit companies (MBFC).

STRUCTURE OF NON-BNAKING FINANCIAL INTERMEDIARIES



1.7.2 Difference between Banking Company and Non-Banking Company

Banking company and Non-banking companies are both financial intermediaries receiving deposits from public and lending them or investing them as the case may be according to circumstances.

S.No.	Banking company	Non-banking company
1	Governed by banking companies Act 1949	Governed by RBI Act, applicable to non-banking companies
2	Banking companies must obtain license from RBI for commencement	No license is required for non-banking companies
3	The Balance Sheet Performer Should Be As Per The Format Provided By RBI	The balance sheet is as per the companies act
4	There is use of negotiable instruments such as cheques, bill of exchange etc	Negotiable instruments cannot be used for withdrawal of money

S.No.	Banking company	Non-banking company
5	Credit rating is not required for accepting deposits	Credit rating is mandatory for accepting deposits from the public
6	All bank deposits are insured up to a certain limit	There is no insurance cover for non-banking company deposits
7	Commercial banks can undertake transactions in foreign exchange	Non-banking companies cannot undertake transactions in foreign exchange
8	Banks can be merged with other commercial banks as per RBI order	Merger of non-banking companies will be as per companies act
9	There can be inspection of banks by RBI periodically	There is no such inspection by RBI
10	There are public sector commercial banks	There are no public sector non-banking companies
11	No ceiling on deposits mobilization	There is a ceiling on acceptance of deposits
12	The lending policy of commercial banks is influenced by the monetary policy of RBI	Lending policy is more decided by the security offered by the borrower
13	Banking companies as a “Big Brother”	Non - Banking companies as a “Small Brother”
14	Commercial banks offer lesser rate of interest	NBFCs charge greater than Commercial banks

Let’s Sum Up

Learners, this section (1.6 & 1.7) encompass two financial institutions namely National Stock Exchange (NSE) and Non-Banking Financial Companies (NBFC). The National Stock Exchange (NSE) and Non-Banking Financial Companies (NBFCs) play crucial roles in India's financial ecosystem, each serving distinct functions but often intersecting in their operations. The NSE is one of the largest stock exchanges in India

and the world, known for its fully automated, electronic trading system which offers a transparent and efficient platform for trading in a variety of financial instruments including equities, bonds, and derivatives. It was established in 1992 to provide a modern, fully automated trading system, the NSE has been instrumental in improving the transparency and efficiency of India's financial markets. NSE operates various segments including the equity market, derivatives market, debt market, and currency derivatives market. It also offers trading in exchange-traded funds (ETFs) and index funds. Regulated by the Securities and Exchange Board of India (SEBI), the NSE follows stringent regulatory and compliance standards to ensure fair trading practices. NBFCs are financial institutions that offer various banking services but do not hold a banking license. They play a vital role in financial inclusion, especially in underserved areas and sectors. NBFCs provide a range of services including loans and credit facilities, asset financing, microfinance, wealth management, insurance, and investment advisory services. Unlike banks, NBFCs cannot accept demand deposits.NBFCs in India are regulated by the Reserve Bank of India (RBI), which ensures they maintain financial stability and follow prudent practices.

Check Your Progress

1. What is the National Stock Exchange (NSE)?

A. A regulatory body overseeing financial institutions
B. A government agency responsible for monetary policy
C. A stock exchange facilitating trading of securities in India
D. A commercial bank offering loans to individuals and businesses

2. Which of the following is NOT a characteristic of Non-Banking Financial Companies (NBFCs)?

A. They accept demand deposits like traditional banks
B. They provide loans and credit facilities
C. They cannot issue checks drawn on themselves
D. They are regulated by the Reserve Bank of India (RBI)

3. What is the primary function of the National Stock Exchange (NSE)?

A. Regulating monetary policy

B. Facilitating trading of stocks, derivatives, and other securities

C. Issuing government bonds

D. Providing insurance services

4. Which regulatory body oversees Non-Banking Financial Companies (NBFCs) in India?

A. Reserve Bank of India (RBI)

B. Securities and Exchange Board of India (SEBI)

C. National Stock Exchange (NSE)

D. Ministry of Finance

5. What distinguishes Non-Banking Financial Companies (NBFCs) from traditional banks?

A. NBFCs cannot provide loans

B. NBFCs cannot accept deposits that are repayable on demand

C. NBFCs are exempt from regulatory oversight

D. NBFCs are government-owned

1.8 Unit Summary

The first unit content on financial services covers several topics and it encompasses a broad range of activities and institutions that manage money and facilitate financial transactions. This sector is essential for economic growth and stability, providing services that support individuals, businesses, and governments. The key components of this section are explained in this unit. Types and roles of financial institutions are examined. And, the primary functions and services offered by each type of financial institution is explained and assessed the importance of financial institutions in facilitating economic activities and growth. The next vital key component that was explained is commercial banks that Offer deposit accounts, loans, mortgages, and other financial products to individuals and businesses. And, Non-Banking Financial Companies (NBFCs) that provide financial services similar to banks but do not have

banking licenses. They offer loans, credit facilities, asset financing, and investment products and play a crucial role in extending credit to underserved sectors.

1.9 Glossary

KEYWORDS	MEANING
Financial Services	Economic services provided by the finance industry, including banking, insurance, investment, and payment services.
Fintech	Technology-driven financial services, including digital banking and peer-to-peer lending.
Cryptocurrency	Digital or virtual currency that uses cryptography for security and operates independently of a central bank.
Factoring	Factoring is a type of finance in which a business would sell its accounts receivable (invoices) to a third party to meet its short-term liquidity needs.
Underwriter	An underwriter is any party, usually a member of a financial organization that evaluates and assumes another party's risk in mortgages, insurance, loans, or investments for a fee, usually in the form of a commission, premium, spread, or interest.
Credit rating	A credit rating is an independent assessment of the ability of a corporation or a government to repay a debt, either in general terms or regarding a specific financial obligation.
Venture capital	Venture capital (VC) is a form of private equity and a type of financing for startup companies and small businesses with long-term growth potential.
Commercial Bank	A financial institution that offers banking services to businesses and individuals, including accepting deposits, providing loans, and offering basic investment products.
Retail Banking	Banking services provided to individual consumers, such as savings accounts, personal loans, and mortgages.

Financial Institution	An organization that provides financial services, such as banks, insurance companies, and investment firms.

1.10 Self-Assessment Questions

Short Answers: (5 Marks)

1. What are financial services?
2. Explain the functions of financial services.
3. Explain the main categories of financial services.
4. Describe the primary functions of commercial banks.
5. Explain the difference between retail banking and commercial banking.
6. Discuss the role of commercial banks in the economy.
7. Briefly discuss the role of following financial institutions:
   a) ICICI
   b) IDBI
   c) IRCI
8. Describe the regulatory role of the Securities and Exchange Commission (SEC).
9. Describe the structure and function of the stock market. How does it facilitate investment and capital formation?
10. State the differences between Banking and Non-Banking Company.

Long Answers: (8 Marks)

1. What is a financial institution, and what are its main types?
2. Briefly elaborate growth of financial services in India and its recent developments.
3. Explain how does interplay between financial services economic and technological environment plays a vital role in shaping modern economies.
4. List and explain the types of financial institutions

1.11 Case Study

Digital Transformation of ABC Bank

Background

ABC Bank, a mid-sized regional bank with a history spanning over 40 years, has primarily served its customers through traditional brick-and-mortar branches. However, with the rise of digital banking and changing customer preferences, ABC Bank faced pressure to modernize its services to stay competitive.

Challenge

The main challenges faced by ABC Bank included:

1. **Customer Expectations**: Increasing demand for online and mobile banking services.
2. **Competition**: Growing competition from fintech companies and larger banks with advanced digital capabilities.
3. **Operational Efficiency**: Need to reduce operational costs and improve efficiency.
4. **Regulatory Compliance**: Ensuring that any new digital services complied with financial regulations.

Strategy

To address these challenges, ABC Bank embarked on a digital transformation journey with the following strategic initiatives:

1. **Developing a Mobile Banking App**: Creating a user-friendly mobile app to offer convenient banking services on the go.
2. **Upgrading Online Banking Platform**: Enhancing the existing online banking platform to provide more features and a better user experience.
3. **Implementing Digital Payment Solutions**: Introducing services like mobile payments, peer-to-peer transfers, and contactless payments.
4. **Enhancing Cybersecurity**: Investing in robust cybersecurity measures to protect customer data and ensure secure transactions.
5. **Training Employees**: Equipping staff with the skills needed to support and promote digital services.

Implementation

1. **Mobile Banking App Launch**: ABC Bank launched a mobile app that allowed customers to check balances, transfer funds, pay bills, and deposit checks using their smartphones.
2. **Online Banking Platform Upgrade**: The bank revamped its online banking portal with a more intuitive interface and additional features such as budgeting tools and financial planning resources.
3. **Digital Payment Solutions**: The bank introduced digital payment options, including integration with popular mobile wallets and real-time P2P payment services.
4. **Cybersecurity Enhancements**: ABC Bank implemented advanced encryption, multi-factor authentication, and continuous monitoring to safeguard customer data.
5. **Employee Training Programs**: The bank conducted extensive training sessions to ensure employees could assist customers with using the new digital services.

Outcomes

1. **Increased Customer Engagement**: The mobile app and upgraded online platform led to a 40% increase in digital banking users within the first six months.
2. **Operational Cost Savings**: Digital services reduced the need for physical branch visits, resulting in a 15% reduction in operational costs.
3. **Enhanced Customer Satisfaction**: Customer feedback indicated a 25% improvement in satisfaction scores due to the convenience and ease of use of the new digital services.
4. **Competitive Positioning**: The introduction of digital payment solutions helped ABC Bank attract younger, tech-savvy customers, increasing new account openings by 20%.
5. **Improved Security**: The enhanced cybersecurity measures ensured a secure banking environment, with no major security incidents reported post-implementation.

Question:

1. **Analyze and summarize the given case study.**

1.12 Answers for Check Your Progress

Modules	S.No.	Answers
Module 1	1.	B. Distribution of wealth
	2.	C. Manufacturing
	3.	C. Managing investments on behalf of clients
	4.	B. Protecting against financial loss from risks such as accidents or illness
	5.	B. Offer short-term, revolving credit
Module 2	1.	B. GDP Growth
	2.	B. To ensure stability and protect consumers
	3.	B. Blockchain Technology
	4.	B. Cybersecurity measures
	5.	C. They influence international trade, investment and market dynamics
Module 3	1.	C. Regulating and supervising the banking sector
	2.	A. 1935
	3.	C. Shaktikanta Das
	4.	D. Managing agricultural subsidies
	5.	D. Central Board of Directors
Module 4	1.	B. Providing loans and accepting deposits
	2.	B. Investment management
	3.	C. Discount rate
	4.	C. Federal Reserve System
	5.	A. Prime rate

Module 5	**1.**	C. Offering long-term finance for industrial development
	2.	C. Industrial Credit and Investment Corporation of India (ICICI)
	3.	B. Providing life insurance and investment services
	4.	B. Facilitating and promoting international trade
	5.	B. Promote industrial development at the state level
Module 6 &7	**1.**	C. A stock exchange facilitating trading of securities in India
	2.	A. They accept demand deposits like traditional banks
	3.	B. Facilitating trading of stocks, derivatives, and other securities
	4.	A. Reserve Bank of India (RBI)
	5.	B. NBFCs cannot accept deposits that are repayable on demand

1.13 Suggested Readings

- **"Financial Markets and Institutions"** by Frederic S. Mishkin and Stanley G. Eakins - A comprehensive overview of the financial markets and institutions, detailing their roles and functions within the financial system. ISBN: 9780134519265.
- **"The Economics of Money, Banking, and Financial Markets"** by Frederic S. Mishkin. Insights into the operation of financial markets, the role of financial institutions, and the influence of monetary policy. ISBN: 9780134733821

1.14 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Financial Institutions of India	https://www.youtube.com/watch?v=OCCjeIG3Nxo
2.	National Stock Exchange	https://www.youtube.com/watch?v=Wn9-Fb4iuqhttps://www.youtube.com/watch?v=Wn9-Fb4iuqss

1.15 References

- Financial Institutions and Markets – L M Bhole, The McGraw-Hill Companies.
- Financial Markets and Services – Gordon & Natarajan, Himalaya Publishing House.
- Indian Banking- S.Natarajan. P.Parameswaran
- Banking &financial institutions - K.K.Jindal
- Investopedia
- World Economic Forum - Reports on Financial Services
- McKinsey & Company - Financial Services Insights
- U.S. Securities and Exchange Commission (SEC)

UNIT 2 - MERCHANT BANKING & STOCK EXCHANGE

Merchant Banking – Functions – Issue management – Managing of new issues – Underwriting – Capital market – Stock Exchange – Role of SEBI

SECTION 2.1: MERCHANT BANKING

Learners in this section will gain a comprehensive understanding of merchant banking, its functions, regulatory environment, and its critical role in supporting corporate finance and capital market activities. And, also will be able to understand Stock Exchanges, i.e., Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) and Securities and Exchange Board of India (SEBI) that Regulates and oversees the capital markets.

2.1.1 Merchant Banker – Meaning and Definition

A merchant banker is one who underwrites corporate securities and advises clients on issues like corporate mergers.

The merchant bankers may be in the form of a bank, a company, firm or even a proprietary concern. It is basically service banking which provides non financial services such as arranging for funds rather than providing them. The merchant banker understands the requirements of the business concerns and arranges finance with the help of financial institutions, banks, stock exchanges and money market.

As per the Securities Exchange Board Of India (Merchant Bankers) rules 1992, **"**Merchant banker" means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, adviser or rendering corporate advisory services in relation to such issue management".

2.1.2 Qualities required for a Merchant Banker

1. Ability to analyze various aspects:

They have the ability to analyze various aspects such as technical, financial and economic aspects concerning the formation of an industrial project.

2. Knowledge:

Knowledge about the various aspects of capital markets, trends in stock exchange, psychology of investing public, change in the economic and technological environment in the country.

3. Ability:

Ability to build up the bank-client relationship and live up to the clients' expectations with total involvement in the project assigned to them.

4. Innovative approach:

Innovative approach in developing capital market instruments to satisfy the ever changing needs of investing public.

5. Integrity and maintenance:

Integrity and maintenance of high professional standards are the essential requisites for the success of merchant bankers' present scenario.

2.1.3 Role of Merchant Bank

Merchant banking in India has a very extensive role to play. The merchant banking division performs the following functions:

1. Helps in obtaining consent of the Central and State Governments, for the project if necessary.
2. Prepares economic, technical and financial feasibility reports,
3. Undertakes initial project preparation; .pre-investment surveys, and market studies.
4. Helps in raising rupee resources from financial institutions and' commercial banks.
5. Underwrites the new issues.

6. Assists in raising foreign exchange resources for the import of machinery and technical know-how and secure foreign collaboration.
7. Advices as to setting up turnkey projects in foreign countries and identifying foreign markets.
8. Helps in financial management and in designing proper capital structure for the company.
9. Advices on restructuring of capital, amalgamation, 'mergers, takeovers etc.
10. Manages investment trusts, charitable trusts etc.
11. Recruits-technical and managerial personnel etc.
12. Subscribes in to the new issues.

2.1.4 Scope of Merchant Banking in India

In a present day capital market scenario, merchant bankers play the role of an encouraging and supporting force to the entrepreneurs, corporate sectors and the investors. There is vast scope for merchant bankers to enlarge their operations both in domestic and international market because of following reasons.

1. Growth of New Issues Market:

The growth of new issue market is unprecedented since 1990-91. The number of capital issues has also increased from 363 in 1990-91 to 900 in 1993-94. The trend is expected to continue in future.

2. Entry of Foreign Investors:

An outstanding development in the history of Indian capital market was its opening up in 1992 by allowing foreign institutional investors to invest in primary and secondary market and also permitting Indian companies to directly tap foreign capital through euro issues.

3. Changing Policy of Financial Institutions:

The policy of decentralization and encouragement of small and medium industries will further increase the demand for technical and financial services which can be provided by Merchant bankers.

4. Development of Debt Market:

The concept of debt market has to set to work through National Stock Exchange and the Over The Counter Exchange of India. Experts feel that of the estimated capital issues of Rs.40,000 crores in 1994-95, a good portion may be raised through debt instruments.

The development of debt market will offer tremendous opportunity to Merchant Bankers.

5. Innovations of Financial Instruments:

The Indian capital market has witnessed innovations in the introduction of financial instruments. This has further extended the role of Merchant Bankers as market makers for these instruments.

6. Corporate Restructuring:

As a result of liberation and globalization the competition in the corporate sector is becoming intense. To survive in the competition, companies are reviewing their strategies, structure and functioning. This offers good opportunity to Merchant Bankers to extend the area of their operations.

7. Disinvestment:

The government raised Rs.2000 crores through disinvestment of equity shares of selected public sector undertakings in 1993-94. The government proposes to shift the present method of periodic sale of public sector shares to round the year off loading of shares directly on the stock exchange from the year 1995-96.

The government will sell the shares of identified public sector at any time during the year when they get a good price above minimum stipulated level. This is likely to provide good business to Merchant Bankers in future.

2.1.5 Functions of Merchant Bankers

1. Corporate Counseling:

Merchant bankers provide counseling services to companies with regard to their timing of issue of shares, capital structure and other promotional aspects with regard to the company. The scope of this function limited to giving suggestions and opinions to the client and helps in taking decisions to solve their problems.

2. Project Counseling:

Here, the new entrepreneurs is helped in the conception of idea identification of various projects, preparation of projects, feasibility reports, location of factory, obtaining funds, sanctions and approval from state and central government departments.

3. Capital Structure:

Here, the amount of capital required, raising of the capital, debt-equity ratio, issue of shares and debentures, working capital, fixed capital requirements etc are worked out.

4. Portfolio Management:

In portfolio, management, the merchant banker helps the investor in matters pertaining to investment decisions. Taxation and inflation are taken into account. The merchant banker also undertakes the function of buying and selling of securities on behalf of their client companies.

5. Issue Management:

Obtaining clearances, drafting of prospectus, underwriting, leasing with brokers and bankers and keeping constant communication with investors.

6. Credit Syndication:

When more funds are required different financial institutions are approached for capital requirements. The financial institutions joining together for providing finance to a needy company is known as Credit syndication. This is also called 'Consortium finance'.

7. Working Capital:

Companies are given working capital finance, depending upon their earning capacities in relation to the interest rate prevailing in the market.

8. Venture Capital:

Venture capital is a kind of finance where in a new venture proposed by an entrepreneur is financial. Venture capital carries more risks and hence very few financial institutions come forward to finance.

9. Lease Finance:

The leasing companies are providing finance for procurement of different assets that are required by different companies. It is a form of finance employed to acquire the use of assets.

10. Fixed Deposit:

Merchant bankers enable companies to raise finance by way of fixed deposits from the public. However, such companies should fulfill credit rating requirements.

The merchant banker helps the borrowing company to accept depositors from the public.

11. Other functions

In addition to the above functions, the merchant banker undertakes the following functions also.

(i) Treasury Management:

Management of cash and short term funds required by client companies.

(ii) Stock Broking:

Access to the stock market, providing odd lot counters and helping upcountry investors through a network of service units.

(iii) Servicing of Issues:

Merchant bankers maintain registers of shareholders and debentures holders of their client companies and distribute dividends and debenture interest. They also have safe custody of securities belonging to their clients.

(iv) Small Scale Industry Counseling:

SSI entrepreneurs are given necessary counseling on marketing and finance by merchant bankers.

(v) Equity research and investment counseling:

Generally a common investor is not in a position to take appropriate investment decision. In order to help such investors, many finance companies are providing equity research and investment counseling.

(vi) Assistance to NRI Investors:

Here the various investors' opportunities in the country are brought to the notice of NRI investors by the merchant banker.

(vii) Foreign Collaboration:

Foreign collaboration agreements (technical and financial) are also arranged by merchant bankers.

(viii) Off-Shore Banking:

Merchant bankers are now allowed to get loans from other countries and invest it in safe and profitable ventures. Here, the MB receives loans from a foreign country which can be invested in the home country, but the same cannot be done vice versa.

(ix) SWAP:

SWAP is yet another trading instrument. In fact, it is a combination of forwards by two counter parties. It is arranged to reap the benefits arising from the fluctuations in the market, either a currency market or interest rate market or any other market for that matter.

2.1.6 Difference between Merchant banking and Commercial banking

BASIS FOR COMPARISON	COMMERCIAL BANK	MERCHANT BANK
Meaning	Commercial bank is a banking company established by a number of people for providing the basic banking functions i.e. accepting deposits and lending money to general public.	Merchant bank refers to the financial institution, that specializes in international trade and provide and array of services to its clients.
Governing Act/body	Regulated by Banking Regulation Act, 1949.	Rules and regulations designed by SEBI.
Engaged in	General banking business	Consultancy type business
Nature of loan extended	Debt-related	Equity-related
Exposure to risk	Less	Comparatively more

BASIS FOR COMPARISON	COMMERCIAL BANK	MERCHANT BANK
Role	Financier	Financial Advisor
Caters	Needs of general public.	Needs of corporate firms.

Let's Sum Up

Learners in this section we have covered merchant banking which is a vital component of the financial services industry, provides essential services that support capital formation, corporate growth, and market development. This section provides an understanding of merchant banking, including its functions, services, and significance in the financial sector. By understanding its functions, significance, and regulatory environment, stakeholders can better navigate the complexities of financial markets and make strategic financial decisions.

Check Your Progress

1. **Merchant banking is defined as:**
   A. The business of providing personal banking services
   B. Offering investment and advisory services for large transactions
   C. Conducting retail sales
   D. Managing local community funds
2. **Which of the following is NOT a primary function of a merchant banker?**
   A. Underwriting of securities
   B. Portfolio management
   C. Offering personal loans
   D. Corporate advisory services
3. **Merchant bankers assist companies in raising capital by:**
   A. Providing grants
   B. Underwriting securities
   C. Issuing debit cards

D. Offering retail banking services

4. **Which regulatory body oversees merchant banking activities in India?**

A. Reserve Bank of India (RBI)

B. Securities and Exchange Board of India (SEBI)

C. Insurance Regulatory and Development Authority of India (IRDAI)

D. National Stock Exchange (NSE)

5. **Merchant banks play a crucial role in:**

A. Providing legal services

B. Offering retail banking services

C. Facilitating international trade

D. Corporate advisory services

SECTION 2.2: ISSUE MANAGEMENT

Issue management has tremendous scope and potential in a growing economy where capital market functions as catalyst for the funding needs of the industry. Issue managers in capital market parlance are known as Merchant Bankers or Lead Managers. Although, the term Merchant Banking, in generic terms, covers a wide range of services such as project counseling, portfolio management, investment counseling, mergers and acquisitions, etc. yet, Issue Management constitutes perhaps the most important and sizeable function within it. So much so, that very often, the terms merchant banking and Issue Management are almost used synonymously.

2.2.1 Issue Management - Meaning

Issue management refers to managing issues of corporate securities like equity shares, preference shares and debentures or bonds. It involves marketing of capital issues, of existing companies including rights issues and dilution of shares by letter of offer. Management of issue also involves other issues.

The decisions concerning size and timing of the public issue in the light of the market conditions are advised by the merchant bankers. In addition to these, the merchant bankers also assist the corporate units on the designing of a sound capital structure acceptable to the financial institutions and determining the quantum and terms of the public issues of different forms of securities. Further, they also advise the issuing company whether to go for a fresh issue, additional issue, bonus issue, right issue or combination of these. In brief, managing public issue is a complicated and technical job. It involves various strategic decisions and coordination of various agencies.

The public issues are managed by the involvement of various agencies i.e., under writers, brokers, bankers, advertising agencies, printers, auditors, legal advisers, registrar to the issue and merchant bankers providing specialized services to make the issue a success. However, merchant bank is the agency at the apex level, who plans, coordinates and controls the entire issue activity and directs different agencies to contribute to the successful marketing of securities.

2.2.2 Public Issue of Securities

When capital funds are raised through the issue of a prospectus, it is called "public issue of securities'. A security issue may take place either at part, or at a premium or at a discount. The Prospectus has to disclose all the essential facts about the company to the prospective purchasers of the shares. Further, the prospectus must conform to the formal set out in Schedule II of the Companies Act, 1956, besides taking into the account SEBI guidelines. SEBI insists on the adequacy of disclosure of information that should serve as the basis for investors to make a decision about the investment of their money.

2.2.3 Pre-issue Management

The pre-issue management involves the following functions:

- Public issue through prospectus.

- Marketing and underwriting.
- Pricing of issues. These may be briefly discussed as follows:

(a) Public issue through prospectus: To being out a public issue, merchant bankers have to coordinate the activities relating to issue with different government and public bodies, professionals and private agencies. First the prospectus should be drafter. The copies of consent of experts, legal advisor, attorney, solicitor, bankers, and bankers to the issue, brokers and underwriters are to be obtained from the company making the issue. These copies are to be filed along with the prospectus to the Registrar Companies. After the prospectus is ready, it has to be sent to the SEBI for clearance. It is only after clearance by SEBI, the prospectus can be filed with the Registrar. The brokers to the issue, principal agent and bankers to issue are appointed by merchant bankers.

(b) Marketing and underwriting: After sending prospectus to SEBI, the merchant bankers arrange a meeting with company representatives and advertising agents to finalize arrangements relating to date of opening and closing of issue, registration of prospectus, launching publicity campaigns and fixing date of board meeting to approve and pass the necessary resolutions. The role of merchant banker in publicity campaigns to help selecting the media, determining the size and publications in which the advertisement should appear. The merchant bank shall decide the number of copies to be printed, check accuracy of statements made and ensure that the size of the application form and prospectus are as per stock exchange regulations. The merchant banker has to ensure that he material is delivered to the stock exchange at least 21 days before the issue opens and to the brokers to the issue, and underwriters in time.

(c) Pricing of issues: Pricing of issues is done by companies themselves in consultation with the merchant bankers. An existing listed company and a new company set up by an existing company with 5 year track record and existing private closely held company and existing unlisted company going in for public issues for the first time with 2 ½ years track record of constant profitability can freely price the issue. The premium can be determined after taking into

consideration net asset value, profit earning capacity and market price. The price and premium has to be stated in the prospectus. Post-issue management consists of collection of application forms and statement of amount received from bankers, screening applications, deciding allotment procedures, mailing of allotment letters, share certificates and refund orders. Merchant bankers help the company by coordinating the above activities.

2.2.4 Post-issue Activities

After the closure of the Issue, Lead Manager has to manage the Post-Issue activities pertaining to the Issue. He has to ensure the submission of the post issue monitoring report as desired by SEBI.

Finalization of Basis of Allotment (BOA): In case of a public offering, besides post-issue lead-manager, registrar to the issue and regional stock-exchange officials, association of public representative is required to participate in the finalization of Basis of Allotment (Annexure 5). Data of accepted applications is finalized and Regional Stock Exchanges are approached for finalization of BOA.

Dispatch of Share Certificates: Then follows dispatch of share certificates to the successful allottees, demat credit, cancelled stock-invest and refund orders to unsuccessful applicants.

Issue of Advertisement in Newspapers: An announcement in the newspaper is also made regarding BOA, number of applications received and the date of dispatch of share certificates and refund orders, etc.

Post-issue Obligations

Lead manager responsible for post-issue activities shall maintain close coordination with the Registrars to the Issue, and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches, processing of the applications including those accompanied by stock invest and other matter till the basis

of allotment is finalized, dispatch completed and listing done. Any act of omission or commission on the part of any such intermediaries noticed during such visits should be duly reported to SEBI.

SEBI imposes considerable responsibility on merchant bankers for proper redressal of investor grievances. It is, therefore, necessary for the merchant bankers to actively associate themselves with the post-issue refund and allotment activities and regularly monitor investor grievances arising there from. To achieve this, the merchant bankers need to evolve effective inter-linkages with the Issuers and the Registrars to Issue. SEBI has launched an all out drive to bring down substantially the number of investor grievances. The merchant bankers are to assign high priority to the area of investor grievances and take all preventive steps to minimize the number of complaints. They are also to set up proper grievance monitoring and redressal system in coordination with the issuers and the registrars to Issue, and take all necessary measures to resolve the grievances quickly to avoid penal action.

In case of delay in refund, lead manager shall ensure that the issuer pays interest for the delayed period as per provisions of the Companies Act, 1956. The lead manager shall be responsible for ensuring dispatch of refund orders/ allotment letters/certificates by registered post only.

Post-issue Monitoring Reports

SEBI prescribed certain post-issue reports which are required to be submitted by the lead managers. Two post-issue reports each for public issue are to be sent by lead managers to SEBI i.e., (a) 3-day post-issue monitoring report and (b) 78-day post-issue monitoring report.

The merchant bankers are expected to keep SEBI informed on important developments about the particular issues being lead managed by them during the intervening period of the reports.

2.2.5 Role of Merchant Bankers in Managing Public Issue

In issue management, the main role of merchant bankers is to help the company issuing securities in raising funds for the purpose of financing new projects, expansion/ modernization/ diversification of existing units and augmenting long term resources for working capital requirements.

The most important aspect of merchant banking business is to function as lead managers to the issue management. The role of the merchant banker as an issue manager can be studied from the following points:

- ***Easy fund raising***: An issue manager acts as an indispensable pilot facilitating a public/ rights issue. This is made possible with the help of special skills possessed by him to execute the management of issues.
- ***Financial consultant***: An issue manager essentially acts as a financial architect, by providing advice relating to capital structuring, capital gearing and financial planning for the company.
- ***Underwriting***: An issue manager allows for underwriting the issues of securities made by corporate enterprises. This ensures due subscription of the issue.
- ***Due diligence***: The issue manager has to comply with SEBI guidelines. The merchant banker will carry out activities with due diligence and furnish a Due Diligence Certificate to SEBI. The detailed diligence guidelines that are prescribed by the Association of Merchant Bankers of India (AMBI) have to be strictly observed. SEBI has also prescribed a code of conduct for merchant bankers.
- ***Co-ordination***: The issue manger is required to co-ordinate with a large number of institutions and agencies while managing an issue in order to make it successful.

- ***Liaison with SEBI***: The issue manager, as a part of merchant banking activities, should register with SEBI. While managing issues, constant interaction with the SEBI is required by way of filing of offer documents, etc. In addition, they should file a number of reports relating to the issues being managed.

Let's Sum Up

Learners in this section we have seen about issue management which deals about *managing issues of corporate securities like equity shares, preference shares and debentures or bonds.* The public issues are managed by the involvement of various agencies i.e., under writers, brokers, bankers, advertising agencies, printers, auditors, legal advisers, registrar to the issue and merchant bankers providing specialized services to make the issue a success. The entire activities of public issue are segregated in to two categories, i.e., Pre-issue Management and post-issue activities. The pre-issue management involves three major functions namely, public issue through prospectus, marketing and underwriting and pricing of issues. And, the post-issue obligations and report has to be submitted by lead managers. Finally, the role of merchant banker in managing the public issue was exemplified in this section.

Check Your Progress

1. **Which of the following best describes issue management?**
   A. Tracking financial transactions
   B. Developing marketing strategies
   C. A systematic approach to handling problems
   D. Evaluating employee performance
2. **Which is NOT a type of public issue of securities?**
   A. Initial Public Offering (IPO)
   B. Follow-on Public Offering (FPO)
   C. Rights Issue
   D. Private Placement
3. **Pre-issue management includes which of the following activities?**

A. Marketing and selling securities

B. Preparing the draft prospectus

C. Distributing dividends

D. Monitoring post-issue activities

4. **Who is primarily responsible for pre-issue management?**

A. Regulatory authorities

B. Merchant bankers

C. Shareholders

D. Company employees

5. **Who typically reviews post-issue monitoring reports?**

A. The company's marketing team

B. Regulatory authorities and stock exchanges

C. The company's HR department

D. Investors and shareholders

SECTION 2.3: MANAGING OF NEW ISSUES

New issue market provides opportunity to issuers of securities, Government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation. The issuers create and issue fresh securities in exchange of funds through public issues and/or as private placement. They may issue the securities at face value, or at a discount/ premium and these securities may take a variety of forms such as equity, debt or some hybrid instrument. They may issue the securities in domestic market and/or international market through ADR/GDR/ECB route.

2.3.1 Functions of New Issue Market

The main function of a new issue market is to facilitate transfer of resources from savers to the users. The savers are individuals, commercial banks, insurance companies etc., The users are public limited companies and the government. The new issue market plays an important role of mobilizing the funds from the savers and

transfers them to borrowers for production purposes, an important requisite of economic growth. The main function of a new issue market are divided in to three are as follows.

- **Origination:** It refers to the work of investigation, analysis and processing of new project proposals. It starts before an issue is actually floated in the market. There are two aspects in this function.
  - ❖ A careful study of the technical, economic and financial viability to ensure soundness of the project.
  - ❖ Advisory service which improve the quality of capital issues and ensures its success.

- **Underwriting:** Underwriting is an agreement whereby the underwriter promises to subscribe to specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed, then there is no liability for the underwriter. If a part of share issues remains unsold, the underwriter will buy the shares. Thus, underwriting is a guarantee for the marketability of shares.

- **Distribution:** The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

2.3.2 Advantages and Disadvantages of New Issue Market

Advantages of New Issue Market

- ✓ Company need not repay the money raised from the market.
- ✓ Money has to be repaid only in the case winding up of buyback of shares.
- ✓ There is no financial burden, because it does not involve interest payment. If the company earns profit, dividend may be paid.

- ✓ Better performance of the company enhances the value for the shareholders.
- ✓ It enables trading and listing of securities at stock exchanges.
- ✓ There is greater transparency in the corporate governance.

Disadvantages of New Issue Market

- ✓ **Aggressive Pricing:** This is the major cause for the sorry state of affairs in the primary market. The near complete freedom given to the issuers and the merchant bankers to fix the premium following the repeal of Capital Issue Act resulted in high premium, sharp erosion of 76 post listing prices and very little scope for appreciation. This made the investors to shy away from the market.
- ✓ **Poor Liquidity:** The poor quality of the primary issues has contributed to a growing inactive list in the stock market.
- ✓ **Low Returns:** Non-implementation of projects, delays, changes in the scope and scale of projects to justify the cost and non-attainment of projected earnings have resulted in the fall in listing price.
- ✓ **Low Volume:** The scrips that are traded in the market, the number of transactions and the amount traded are so low that an investor wanting to sell the scrip would have difficulty in doing so.

2.3.3 Methods of Floating New Issues in the Primary Market

a) Public Issue:

Public Issue The most popular method for floating the issues in new issue market is through "prospectus" which is viewed as a legal document. A common method followed by corporate enterprises to raise capital through the issue of securities is by means of a prospectus inviting subscription from the public. Under this method, the issuing companies themselves offer directly to the general public a fixed number of shares at a stated price known as the face value of the securities. Public issues can be further classified into Initial Public Offerings (IPOs) and Further Public Offerings (FPOs). The prospectus must state the following

- ➢ Name of the company

- Address of the registered office of the company.
- Existing and proposed activities of the company.
- Names of the directors.
- Authorised and proposed issue capital to the public
- Dates of opening and closing the subscription list.
- Minimum subscription

b) Offer for Sale:

Under this method, instead of issuing company itself offering its shares directly to the public, it offers through the sponsoring intermediary of issue houses/merchant banks/investment banks or firms of stockbrokers are hired to offer the share to the public. It is a method of floatation of share through an “intermediary” and “indirectly” through an issue house for converting the private company into public company.

c) Private Placement :

In this method the issue is placed with a small number of financial institutions, corporate bodies and high net worth individuals. The financial intermediaries purchase the shares and sell them to investors at a later date at a suitable price. The stock is placed with issue house client with the medium of placing letter and other documents which taken together contribute a prospectus, giving the information regarding the issue. The special feature of the private placement is that the issues are negotiated between the issuing company and the purchasing intermediaries. Listed public limited company as well as closely held private limited company can access the public through the private placement method.

d) Rights Issue:

It means an issue of capital to be offered by the company to its existing shareholders through a letter of offer, under section 81 (1) of the Companies Act 1956. A listed company issues fresh securities to its existing shareholders only. The rights are offered in a specified ratio to number of securities held prior to the issue by the shareholder. The ratio is fixed on the basis of the capital requirement of the company. The stake of the existing shareholders is not diluted in the rights issue. When the rights issue size is more than 50 lakh, the company has to file a draft offer document with SEBI for observations. SEBI’s observation letter is valid for three months.

e) Issue of Indian Depository Receipts (IDR):

A foreign company which is listed in stock exchange abroad can raise money from Indian investors by selling (issuing) shares. These shares are held in trust by a foreign custodian bank against which a domestic custodian bank issues an instrument called Indian depository receipts (IDR), denominated in `. IDR can be traded in stock exchange like any other shares and the holder is entitled to rights of ownership including receiving dividend.

2.3.4 Parties involved in the New Issue Market

- **Lead Managers**

Lead managers are appointed by the company to manage the initial public offering campaign. Their main duties of the lead managers are drafting of prospectus, preparing the budget of expenses related to the issue, suggesting the appropriate timings of the public issue, assisting in marketing the public issue successfully, advising the company in the appointment of registrars to the issue, underwriters, brokers, bankers to the issue, advertising agents etc. And directing the various agencies involved in the public issue. The merchant banking division of the financial institutions, subsidiary of commercial banks, foreign banks, private sector banks and private agencies are available to act as lead managers. The company negotiates with prospective mangers to its issue and settles its selection and terms of appointment. Usually companies appoint lead managers with a successful background. There may be more than one manager to the issue.

- **Registrar to the Issue**

After the appointment of the lead managers to the issue, in consultation with them, the Registrar to the issue is appointed. Quotations containing the details of the various functions they would be performing and charges for them are called for selection. Among them the most suitable one is selected. It is always ensured that the registrar to the issue has the necessary infrastructure like Computer, Internet and telephone. The Registrars normally receive the share application from various collection centers. They recommend the basis of allotment in consultation with the Regional Stock

Exchange for approval. They arrange for the dispatching of the share certificates. They hand over the details of the share allocation and other related registers to the company. Usually registrars to the issue retain the issuer records at least for a period of six months from the last date of dispatch of letters of allotment to enable the investors to approach the registrars for redressal of their complaints.

- **Bankers to the Issue**

Bankers to the issue have the responsibility of collecting the application money along with the application form. The bankers to the issue generally charge commission besides the brokerage, if any. Depending upon the size of the public issue more than one banker to the issue is appointed. When the size of the issue is large, 3 to 4 banks are appointed as bankers to the issue. The number of collection centers is specified by the central government. The bankers to the issue should have branches in the specified collection centers. In big or metropolitan cities more than one branch of the various bankers to the issue are designated as collecting branches. Branches are also designated in the different towns of the state where the project is being set up. If the collection centers for application money are located nearby people are likely to invest the money in the company shares.

- **Advertising Agents**

Advertising plays a key role in promoting the public issue. Hence, the past track record of the advertising agency is studied carefully. Tentative program of each advertising agency along with the estimated cost are called for. The advertising agencies take the responsibility of giving publicity to the issue on the suitable media. The media may be newspapers/magazines/hoardings/press release or a combination of all.

- **Financial Institutions**

Financial institutions generally underwrite the issue and lend term loans to the companies. Hence, normally they go through the draft of prospectus, study the proposed program for public issue and approve them. IDBI, IFCI & ICICI, LIC, GIC and UTI are the some of the financial institutions that underwrite and give financial assistance. The lead manager sends copy of the draft prospectus to the financial institutions and includes their comments, if any in the revised draft.

- **Underwriters**

Underwriting is an agreement with or without conditions to subscribe to the securities of a body corporate in the event of non- subscription by the public. In other words, if there is under- subscription (the amount received is less than the issue size), the underwriters subscribe to the unsubscribed portion. The person who assures the sum is called and underwriter. The underwriters are paid an underwriting commission. A certificate of registration from SEBI has to be obtained by the agencies that wish to carry out underwriting activities. After the selection of the underwriter, the issuing company enters into an agreement with the underwriter. The agreement contains will remain in force.

- The period during which the agreement will remain in force.
- The amount of the underwriting obligation.
- The maximum period within which the underwriter will have to subscribe to the offer after the company's intimation.
- The rate and amount of commission or brokerage chargeable by the underwriter.

- **Share Transfer Agents**

They maintain the records of the holders of securities of the company for and on behalf of the company. They also handle all the matters related to transfer and redemption of securities of the company.

- **Brokers**

Appointing a broker is not compulsory, but approval of the stock exchange is mandatory. The names and addresses of the brokers to the issue should be given in the prospectus. The brokers enhance the sale of issue. Their other functions have been given.

- ✓ Use their contacts to invite the public for subscribing shares.
- ✓ Act as a connecting link between the prospective investors and the issue.
- ✓ Enhance the speedy subscription of the issue by the public.

The issuing company pays brokerage according to the provisions in the Companies Act, and guidelines prescribed by the SEBI. Regarding the payment, an agreement is made between the broker and the issuing company.

❖ **Depositories**

They are the intermediaries who hold the securities in dematerialized form on behalf of the shareholders. They enable transactions of securities by book entry. The depository system links the issuers, depository participants, NSDL and Clearing Corporation / houses of the stock exchanges. Transfers are affected by means of account transfers.

2.3.5 Marketing of New Issues

Marketing of new issues following are the steps involved in the marketing of the issue of securities to be undertaken by the lead manager:

1. **Target market:** The first step towards the successful marketing of securities is the identification of a target market segment where the securities can be offered for sale. This ensures smooth marketing of the issue. Further, it is possible to identify whether the market comprises of retail investors, wholesale investors or institutional investors.

2. **Target concentration:** After having chosen the target market for selling the securities, steps are to be taken to assess the maximum number of subscriptions that can be expected from the market. It would work to the advantage of the company if it concentrates on the regions where it is popular among prospective investors.

3. **Pricing:** After assessing market expectations, the kind and level of price to be charged for the security must be decided. Pricing of the issue also influences the design of capital structure. The offer has to be made more attractive by including some unique features such as safety net, multiple options for conversion, attaching warrants, etc.

4. **Mobilizing intermediaries:** For successful marketing of public issues, it is important that efforts are made to enter into contracts with financial intermediaries such as an underwriter, broker/sub-broker, fund arranger, etc.

5. **Information contents:** Every effort should be made to ensure that the offer document for issue is educative and contains maximum relevant information. Institutional investors and high net worth investors should also be provided with detailed research on the project, specifying its uniqueness and its advantage over other existing or upcoming projects in a similar field.

6. **Launching advertisement campaign:** In order to push the public issue, the lead manager should undertake a high voltage advertisement campaign. The advertising agency must be carefully selected for this purpose. The task of advertising the issue shall be entrusted to those agencies that specialize in launching capital offerings. The theme of the advertisement should be finalized keeping in view SEBI guidelines. An ideal mix of different advertisement vehicles such as the press, the radio and the television, the hoarding, etc. should be used. Press meets, brokers and investor's conference, etc. shall be arranged by the lead manager at targeted in carrying out opinion polls. These services would useful in collecting data on investors' opinion and reactions relating to the public issue of the company, such a task would help develop an appropriate marketing strategy. This is because; there are vast numbers of potential investors in semi-urban and rural areas. This calls for sustained efforts on the part of the company to educate them about the various avenues available for investment.

7. **Brokers and investors conferences:** As part of the issue campaign, the lead manager should arrange for brokers and investors conferee centre which have sufficient investor population. In order to make such endeavors more successful, advance planning is required. It is important that conference materials such as banners, brochures, application forms, posters, etc. reach the conference venue in time. In addition, invitation to all the important people, underwriters, bankers at the respective places, investors associations should also be sent.

8. A critical factor that could make or break the proposed public issue is its timing. The market conditions should be favorable. Otherwise, even issues from a company with an excellent track record, and whose shares are highly priced, might flop.

Similarly, the number and frequency of issues should also be kept to a minimum to ensure success of the public issue.

Let's Sum Up

Learners, this section holds concepts related to managing new issues, which deals about new issues that provides opportunity to issuers of securities, Government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation. The three main functions of new issue market are origination, underwriting and distribution. Though issuing new market has many advantages, it has its own drawback like premium pricing, poor liquidity, low returns and low volume. the methods of floating new issues in the primary market are public issue, offer for sale, private placement, rights issue, and issue of Indian Depository Receipts. And, the parties involved in the new issue market are lead managers, registrar, bankers, advertising agents, financial institutions, underwriters, share transfer agents, brokers, and depositories. And, the steps involved in the marketing of the issues of securities is to identify target market, next is to assess the maximum number of subscriptions, after assessing the market expectations, the type and price level for the security must be decided, then it is vital to enter into contracts with financial intermediaries, the offer document has to be checked that whether it holds relevant information, as a part of this campaign the lead manager should arrange conferences for brokers and investors.

Check Your Progress

1. What is the primary objective of managing new issues?

A. Increasing company profits

B. Expanding the company's market share

C. Raising capital for the company

D. Reducing operational costs

2 Which is the first step in managing new issues?

A. Pricing the issue

B. Preparing the prospectus

C. Selecting the underwriters

D. Marketing the issue

3 Which of the following is NOT a function of the new issue market?

A. Providing a platform for companies to raise capital

B. Enabling investors to buy new securities

C. Facilitating trading of existing securities

D. Assisting in the price discovery of new issues

4 Which of the following is an advantage of the new issue market?

A. High initial costs for issuers

B. Increased scrutiny from regulatory bodies

C. Access to a large pool of capital

D. Dilution of ownership for existing shareholders

5 Which method involves the company directly offering its shares to the public?

A. Rights issue

B. Private placement

C. Public issue

D. Preferential allotment

SECTION 2.4: UNDERWRITING

2.4.1 Underwriting - Meaning

Underwriting is an act of guarantee by an organization for the sale of certain minimum amount of shares and debentures issued by a public limited company. According to companies Act, when a person agrees to take up shares specified in the underwriting agreement, when the public or others have failed to subscribe for them, it is called underwriting agreement.

Underwriting is one of the most important functions in the financial world wherein an individual or an institution undertakes the risk associated with a venture, an investment, or a loan in lieu of a premium. Underwriters are found in banking, insurance, and stock markets.

2.4.2 Importance of Underwriting

The persons responsible for issuing shares in the company, known as *issuers*, have the option of deciding for the underwriting of shares. If the issue is not underwritten, there is a possibility of the issue editing under subscribed and even if 90% of minimum subscription is not received, the money has to be refunded in full. Hence, there is an urgent need on the part of the issuer, to seek the assistance of underwriters for a successful completion of issue of shares.

2.4.3 Functions of Underwriting

1. Purchase of Securities

The main function of underwriters is to purchase the securities of financially sound Companies either direct from the company or from the market. Thus, they maintain their goodwill in the market a stockiest of good securities.

2. Distribution of Securities

Underwriters distribute the securities to the real investors after entering the agreement with the issuing company. The underwriters take up securities under an obligation under underwriting contract or sometimes make firm underwriting and distribute such securities to the investors by selling them in the market at the earliest.

3. Supplying Information of Companies

Underwriters supply important information in regard to investors' attitude, market conditions etc. to the issuing company and to suggest necessary changes in their financial plans.

Customers or investors in securities get valuable information from underwriters regarding the financial position on the policies of different companies. Sometimes their expert advices are published in journals etc.

4. Exchange in Securities

Underwriters provide stability in the price of securities by purchasing a selling the various securities by maintaining equilibrium in the demand and supply position of the securities and thus keep the market alive.

5. Other Services

Underwriters sometimes finance the projects of the company. They also inform the investors about opportunities but this type of service is not popular in India. It is much popular in U.S.A.

2.4.4 Types of Underwriting

.Different types of underwriting are as follows:

1. **Firm underwriting:**

Firm underwriting means when an underwriting agreement where an underwriter agrees to buy a definite number of shares or debentures in addition to the shares or debentures he has to take under the underwriting agreement. In firm underwriting, the underwriters are liable to take up the agreed number of shares or debentures even if the issue is over subscribed.

2. **Complete underwriting:**

When the whole issue of shares or debentures of a company is underwritten, it is called complete underwriting. In such a case the whole issue is underwritten either by an individual/institution agreeing to take the entire risk or by a number of firms or institutions, each agreeing to take the risk to a limited extent.

3. **Partial underwriting**.

When only a part of the issue of shares or debentures of a company is underwritten, it is known as partial underwriting. In such a case the part of the issue is underwritten either by an individual/institution or by a number of firms or institutions each agreeing to take the risk to a limited extent.

4. **Syndicate Underwriting:**

When the issue is very big and it is impossible to be underwritten by a single underwriter syndicate underwriting comes to rescue. In syndicate underwriting, few underwriting firms form a syndicate and jointly undertake to underwrite the issue. The amount to be underwritten and the ratio is determined in advance among the firms.

5. **Joint Underwriting:**

In joint underwriting, when the issue is too large, the issuer company itself appoint more than one underwriter to reduce the burden from a single underwriter. Each

Underwriter underwrites for a specified amount and in a specified ratio. It is different from a syndicate underwriting in a way that in Syndicate underwriting the underwriting firm themselves form a syndicate and represent themselves as single underwriting firm but in joint underwriting, the issuer company itself appoint a number of firms to underwrite the issue.

6. Sub-underwriting:

If an underwriter has promised to underwrite an issue and later on it feels that it is beyond his individual capacity, then he may appoint a sub-underwriter to safeguard himself. For example, if an underwriter A has underwritten for an amount of 40 crores, and later on he finds it difficult to underwrite single Handily he may appoint a sub-underwriter to underwrite 10 crores. In this case, the sub-underwriter is liable to underwriter only and he has no connection with the company. The relationship between underwriter and sub-underwriter is same as an agent and sub-agent.

2.4.5 Merits and Demerits of Underwriting

1. Underwriting ensures success of the proposed issue of shares since it provides an insurance against the risk.
2. Underwriting enables a company to get the required minimum subscription. Even if the public fail to subscribe, the underwriters will fulfil their commitments.
3. The reputation of the underwriter acts as a confidence to investors. The underwriters who are called the lead managers provide financial recognition to the company, whose shares are issued to the public. Thus, the reputation of the issuing company also improves because of the reputation of underwriters.

Demerits of underwriting:

1. Sluggish and dormant capital market has resulted in the slow progress of underwriting
2. Managing agency system, prevalent in the corporate world, in responsible for the slow growth of the underwriting

3. The bashful nature of Indian investors is responsible for the show progress of underwriting
4. For the underwriting service to take place and flourish, it requires specialized financial institutions. Such institutions are not available in the Indian capital market.

Let's Sum Up

Learners this section includes underwriting which is a critical process in the financial services industry that involves assessing and evaluating the risk of potential clients or investments to determine the appropriate terms and conditions. This unit covers the key concepts, methods, and functions and importance of underwriting Learners will learn about different types of underwriting, such as firm underwriting, complete underwriting, partial underwriting, syndicate underwriting, joint underwriting and sub-underwriting, By the end of this unit, students will have a comprehensive understanding of how underwriting supports the financial services industry in managing risk and facilitating informed financial decisions.

Check Your Progress

1. **What is underwriting in the context of finance?**

   A. The process of signing a financial agreement

   B. The assessment of risk involved in an investment

   C. The issuance of stock certificates

   D. The management of a company's accounting records

2. **Who are the primary parties involved in the underwriting process?**

   A. Lenders and borrowers

   B. Issuers and investors

   C. Underwriters and issuers

   D. Regulators and companies

3. Which of the following is a primary function of underwriting?

A. Marketing the securities

B. Preparing financial statements

C. Conducting annual audits

D. Managing company payroll

4. Which type of underwriting involves multiple underwriters sharing the risk?

A. Firm commitment underwriting

B. Best efforts underwriting

C. Syndicate underwriting

D. Standby underwriting

5. What is the role of an underwriter in an IPO?

A. To regulate the issuing process

B. To evaluate and take on the risk of distributing the securities

C. To manage the company's internal finances

D. To buy back shares from the market

SECTION 2.5: CAPITAL MARKET

2.5.1 Capital Market – Meaning & Definition

Capital market simply refers to a market for long term funds. It is a market for buying and selling of equity, debt and other securities. Generally, it deals with long term securities that have a maturity period of above one year. Capital market is a vehicle through which long term finance is channelized for the various needs of industry, commerce, govt. and local authorities.

According to W.H. Husband and J.C. Dockerbay, *“the capital market is used to designate activities in long term credit, which is characterised mainly by securities of investment type”.*

Thus, capital market may be defined as an organized mechanism for the effective and smooth transfer of money capital or financial resources from the investors to the entrepreneurs.

2.5.2 Characteristics of Capital Market

- It is a vehicle through which capital flows from the investors to borrowers.
- It generally deals with long term securities.
- All operations in the new issues and existing securities occur in the capital market.
- It deals in many types of financial instruments. These include equity shares, preference shares, debentures, bonds, etc. These are known as securities. It is for this reason that capital market is known as 'Securities Market'.
- It functions through a number of intermediaries such as banks, merchant bankers, brokers, underwriters, mutual funds etc. They serve as links between investors and borrowers.
- The constituents (players) in the capital market include individuals and institutions. They include individual investors, investment and trust companies, banks, stock exchanges, specialized financial institutions etc.

2.5.3 Functions of Capital Market

The functions of an efficient capital market are as follows:

- Mobilise long term savings for financing long term investments.
- Provide risk capital in the form of equity or quasi-equity to entrepreneurs.
- Provide liquidity with a mechanism enabling the investor to sell financial assets.
- Improve the efficiency of capital allocation through a competitive pricing mechanism.
- Disseminate information efficiently for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment etc.

- Enable quick valuation of instruments – both equity and debt.
- Provide insurance against market risk through derivative trading and default risk through investment protection fund.
- Provide operational efficiency through:
  - ✓ simplified transaction procedures,
  - ✓ lowering settlement times, and
  - ✓ lowering transaction costs.
- Develop integration among:
  - ✓ debt and financial sectors,
  - ✓ equity and debt instruments,
  - ✓ long term and short term funds.
- Direct the flow of funds into efficient channels through investment and disinvestment and reinvestment.

2.5.4 Major Players or Participants (or Intermediaries) in the Capital Market

There are many players (intermediaries) in the primary market (or capital market). Important players are as follows:

✓ **Merchant bankers:** In attracting public money to capital issues, merchant bankers play a vital role. They act as issue managers, lead managers.

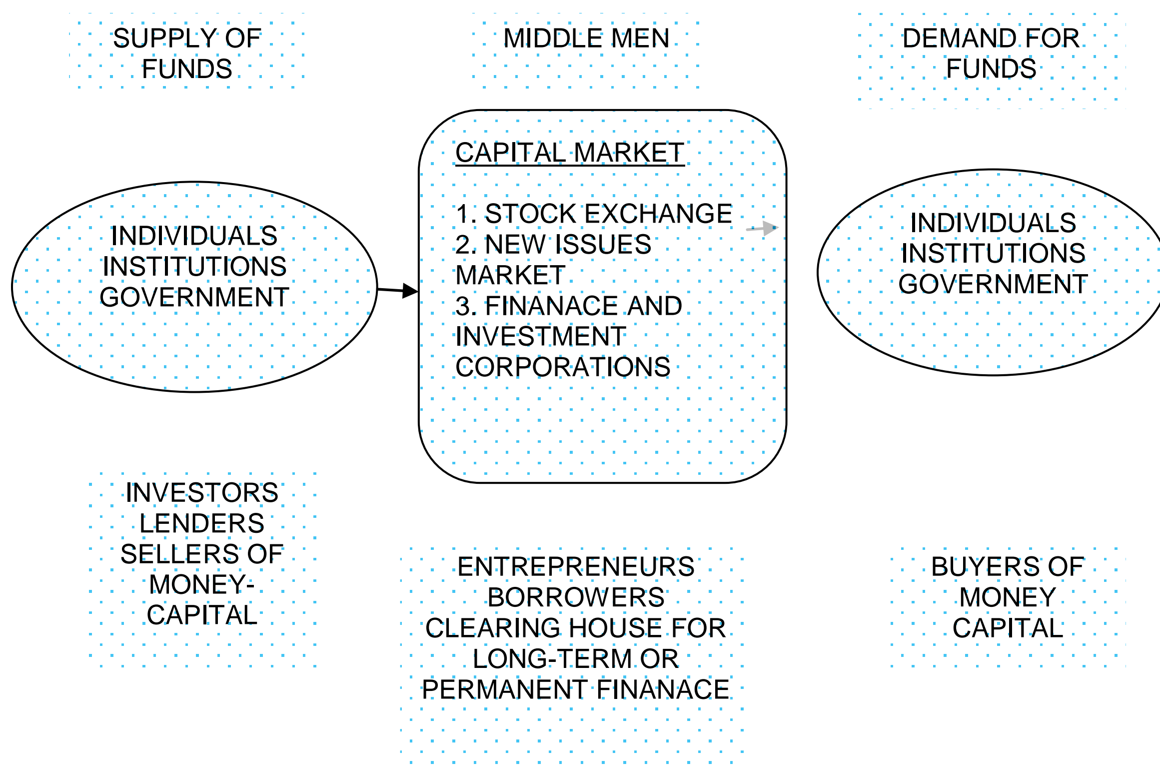
✓ **Registrars to the issue**: Registrars are intermediaries who undertake all activities connected with new issue management. They are appointed by the company in consultation with the merchant bankers to the issue.

✓ **Bankers:** Some commercial banks act as collecting agents and some act as co-ordinating bankers. Some bankers act as merchant bankers and some are brokers. They play an important role in transfer, transmission and safe custody of funds.

- ✓ **Brokers**: They act as intermediaries in purchase and sale of securities in the primary and secondary markets. They have a network of sub brokers spread throughout the length and breadth of the country.

- ✓ **Underwriters**: Generally investment bankers act as underwriters. They agreed to take a specified number of shares or debentures offered to the public, if the issue is not fully subscribed by the public. Underwriters may be financial institutions, banks, mutual funds, brokers etc.

2.5.5 Mechanism of Capital Market



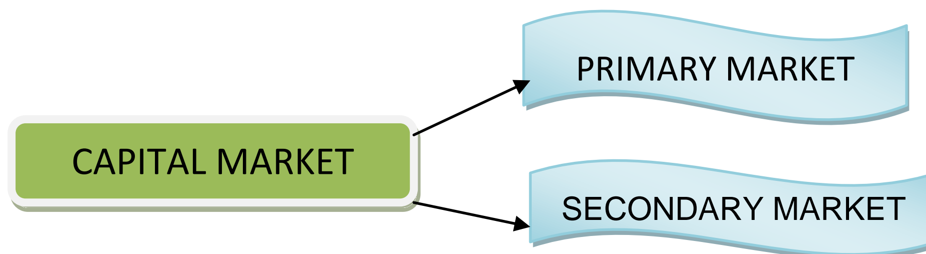
The Capital market is directly responsible for the following activities:

1. Mobilization or concentration of national savings for economic development
2. Mobilization and import of foreign capital and foreign investment capital plus skill to fill up the deficit in the required financial sources to maintain the expected rate of economic growth

3. Productive utilization of financial resources
4. Directing the flow to funds of high yields and also strive for balanced and diversifies industrialization.

2.5.6 Classification of Capital Market

The capital market comprises of two markets, *viz.,* the Primary market and the Secondary market.



Primary Market

The primary market consists of new issues of capital (equity, debentures, bonds, etc.), by new/existing companies. In this case, the corporate body invites applications to its issue of equity or debentures by filling a prospectus or letter of offer. The application forms can be obtained from the bankers/merchant bankers of the issues, brokers, etc.

Investors subscribe to these issues by filling in the application forms and remitting the requisite amount to the designated banks (listed on the reverse of the application) within the time period for which the subscription list is open. The subscription list is generally kept open for three days.

The company in consultation with its merchant bankers and the Stock Exchange authorities is expected to finalize the list of successful applications within 10 weeks. Thereafter, the share/ debenture certificates are dispatched to the successful application while refund orders are posted to others.

Advantages and Disadvantages of Primary Market:

1. A Cost-Effective Way to Raise Capital

Companies can raise capital for their business cost-effectively and seamlessly in a primary market. Also, securities offered in the primary market can almost be instantly sold in the secondary market, thus providing high liquidity.

2. Less Chances of Price Manipulation

As compared to secondary market, there are less chances of price manipulation in the primary market. This leads to better transparency and operations.

3. Offers Diversification

Primary market serves as a potential avenue for diversification for investors, thus bringing down the quantum of risk. Investors can allocate their investments across asset classes in multiple financial instruments.

There are also certain disadvantages of primary market. They are:

1. Limited Information Available to Investors

Often there may be limited information available to investors before they invest in an IPO. This is because unlisted companies are outside the purview of SEBI's regulations.

2. No Historical Trading Data

As shares are issued for the first time, there's no historical data available to analyze the IPO shares. This can make investment a little difficult. Also, if a share is oversubscribed, then small investors may not be able to receive their allocation.

3. A last word

When you invest in the stocks, keep an eye on the primary market too. This is because IPOs can have great potential to offer big returns to investors. No wonder there is a lot of excitement around each IPO announcement.

Concepts related to Primary Market

a. Offer document

The offer document means prospectus. This document covers all the relevant information about the company. The data is about the company, its promoters, the project, financial details and past performance, objects of raising money, terms of issue, etc. This helps the investor to make their investment decision.Companies issue offer document while raising capital from the public. Companies issue offer document in case of a public issue or offer for sale. For a rights issue, a letter of offer is issued. The

company files the offer document with the Registrar of Companies (ROC) and stock exchanges.

b. Price band

The price band of an IPO is the offer price of the company's shares. The lead manager decides the price band for any IPO. There is no specific or standard calculation for it. It is determined by looking at the company's valuation and prospects. The company announces its price band, and then investors make their bid. Once the company receives the requests, it decides a particular price for the listing of shares. The spread between the floor price and the cap price shall not be more than 20%. The price band can be revised. If the price revises, then the bidding period also extends for three more days.

c. Cut off price

A cut off price is any price that an investor can bid. In other words, the investor is ready to pay whatever price the company decides at the end of the book-building process. The retail investors pay the highest price while placing the bid at cut-off price. If the company chooses the final price lower than the highest price, the remaining amount is returned to the investor. The company's employees are eligible to bid in the employee reservation portion. Also, the retail investors are allowed to bid at the cut-off price. However, QIBs (including anchor investors) and non-institutional investors are not allowed to bid at the cut off price.

d. Floor price

The floor price is the lowest price in the share price band. It is the price at and above which investors can place their bids. On the other hand, the highest price in the price band is called the cap price. For example, The company fixes the share price band Rs.1000-Rs.1010. Here, the lower end range that is Rs.1000 is called as the floor price. This is the minimum price at which IPO is issued. On the other hand, the upper limit of the price band is Rs.1010, which is the cap price or maximum price.

e. Face value

The face value of a share is the value at which the share is listed on the stock market. Face value is also called par value. The face value is determined when the company issues shares to raise capital. Hence, one cannot calculate the face value. It

remains fixed and never changes. However, if a company decides to split the shares, then the face value can change. Mostly, Indian company shares have a face value of Rs.10. The face value is significant in the stock market for legal and accounting reasons. When a shareholder buys a stock, the company issues a share certificate that has face value mentioned.

Secondary Market

The secondary market is where listed securities are bought and sold. Shares are normally issued having a face value of `10' or `100'. The trading is normally done in what are known as market lots. For a share of face value `10', the market lot is 50 or 100 and for `100', the market lot is 1 or 5 shares respectively.

In the secondary market one can buy and sell securities, invest and disinvest or channel funds from one company to another or one type of security into another.

The secondary market is thus an important adjunct of the primary market. The activity in these two markets is inter-linked and the indicators are also related although separate in themselves and the starting link is listing of issues on the Stock Markets.

In the secondary market, the move to an electronic trading system has resulted in transparency in trades, better price discovery and lower transaction costs. The efficiency of the market has improved through faster execution of trades. The operational efficiency of the stock market has also been strengthened through improvements in the clearing and settlement practices and the risk management process. Almost the entire delivery of securities now takes place in dematerialized form.

Secondary Market Instruments

The instruments available in the aftermarket to trade in are broadly classified into three categories:

a. Fixed Income Instrument

As the name implies, these instruments form part of investments that guarantee fixed income in the form of regular payments. For example, the interest paid monthly

and the principal amount on maturity fall under this category. Some of the other examples include debentures, bonds, etc.

b. Variable Income Instrument

Investments made in these instruments do not guarantee a fixed, regular income. Instead, the returns vary based on the market fluctuations. The investment made, in this case, involves high risk and, at the same time, it can be highly rewarding. Based on the risk and reward factors, the returns are generated. Some of the examples of variable income instruments include equity and derivatives.

c. Hybrid Instrument

A few secondary market instruments offer both fixed and variable returns on investments. For example, a convertible debenture acts as primary debt security and could be converted into equity shares after a set period.

Types of Secondary Market

- **Stock Exchanges**

A stock exchange is a centralized platform where trading occurs. Investors can buy or sell stocks without having to know each other personally. The only thing that matters is whether the prices suit buyers to purchase and sellers to sell the stocks. The exchanges work under strict regulation and only list stocks or assets for trade when fully verified. Thus, investing in securities via exchanges is the safest and most trustworthy option for small and big investors. The stock exchange services can be enjoyed for commission and exchange charges. Some well-known stock exchanges are the National Stock Exchange (NSE), the New York Stock Exchange (NYSE), the NASDAQ, etc.

- **Over-the-Counter (OTC) Markets**

An OTC market allows individual participants to deal with each other. However, this decentralized platform is where investors remain at a higher risk due to the lack of regulatory mechanisms. With increased competition, every individual or entity tries to invest and grab a high volume of stocks to trade in the future. As a result, the

securities prices may vary from one participant to another. FOREX is an example of an OTC market.

Besides the above two types, a few more are less popular. These include dealer market and auction market. In a dealer market, dealers fix a trade price, while in an auction market, the buyers and sellers can negotiate and take a trade forward accordingly.

2.5.7 Capital Market Structure

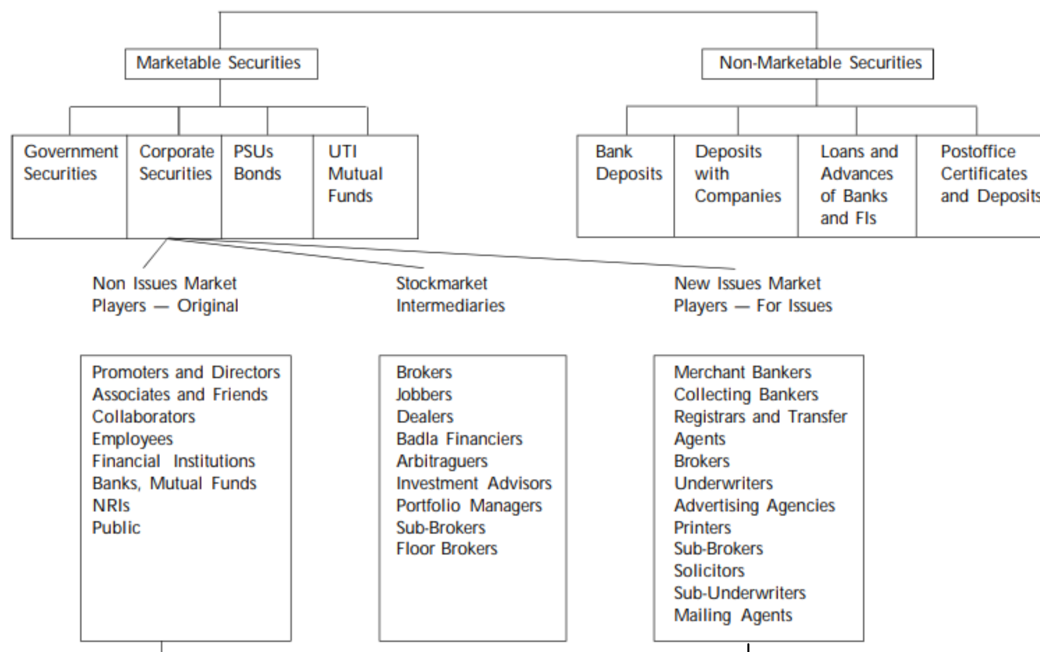
An important segment of the organized financial system comprises of the new issues market and stock market. The term capital market is a wide term, encompassing all long-term claims of money-lending and borrowings. It thus includes all term lendings by banks and financial institutions and long-term borrowings from foreign markets and new issues by companies and rising of all resources from public through issue of new securities, deposits, loans, etc.

As the below chart shows, capital market includes issues of two major categories — marketable and non-marketable. Whether marketable or not, these are issued by government and government departments, companies, public sector units, mutual funds, UTI, etc. LIC and GIC sell policies and collects savings from public, which are not marketable. The other non-marketable securities or claims are issued by post offices as savings certificates, deposit receipts, etc., non-securitized loans and advances of banks and financial institutions, deposits with banks and companies and securities of private limited companies and finance company deposits/loans, chit fund etc. The marketable securities are issued through the new issues market and are traded through the stock market.

The contributors to new issues are promoters, collaborators, if any, employees, NRIs, banks, FIs, Mutual Funds and the public at large. The players through whom these issues are managed are mainly merchant bankers, registrars, brokers, mutual funds, etc., which are dealt with in detail in later chapters. The ancillary functions and complementary to the above is those of underwriters, collecting bankers, printers, advertising agents etc. The main players in the stock market, namely, brokers,

investment consultants, portfolio managers, investment managers, etc., are also discussed in later chapters.

The capital market study should authentically encompass both the marketable and non- marketable segments. In view of the fact that demand and supply forces and trading activity is confined only to the segment of marketable securities, this book is using the term 'Capital Market' in the sense of marketable securities. Thus, more prominent issuers of such securities are public limited companies and, government and the more popular instruments traded in the market are equity, debentures, bonds, etc., which are discussed in this book. UTI and the mutual fund schemes being popular for trading, they are also dealt with. Briefly the major players — instruments and activity in capital market are covered from the point of management.



Capital Market Structure

Capital Market Instruments:

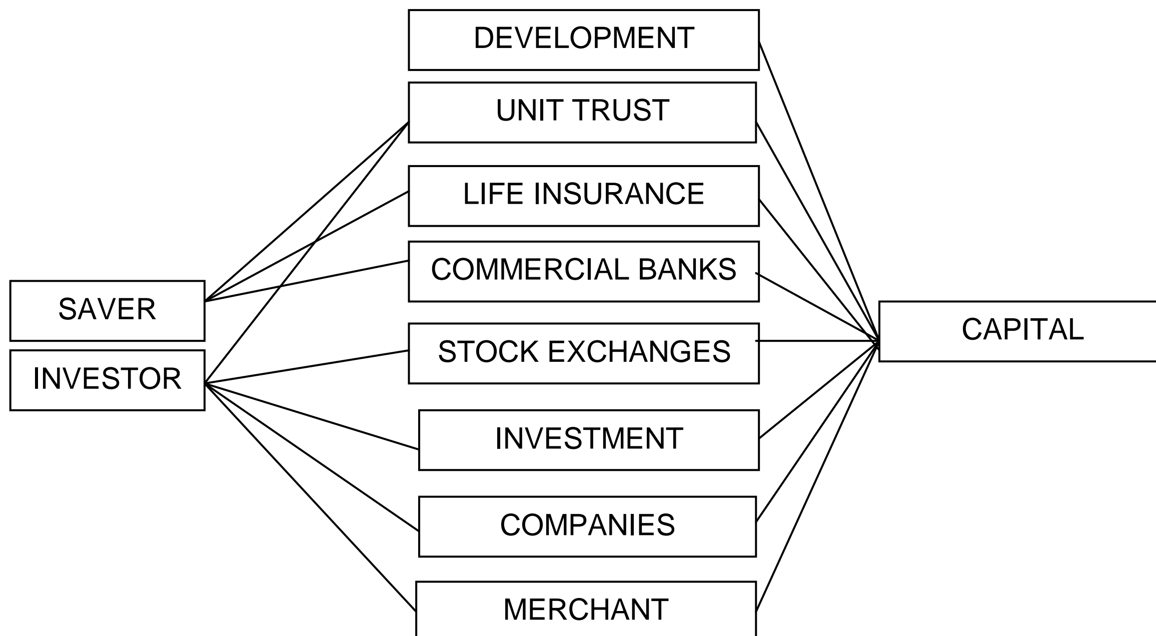
The following instruments are being used for raising resources:

- ✓ Equity shares
- ✓ Preference shares
- ✓ Non-voting equity shares
- ✓ Cumulative convertible preference shares

- ✓ Company fixed deposits
- ✓ Warrants
- ✓ Debentures/bonds
- ✓ Secured premium notes (SPNs)
- ✓ Euro Convertible Bonds (ECBs)/Global Depository Receipts (GDRs).

2.5.8 Current Indian Capital Market

The Indian capital market is second in size only to that of the USA, in terms of availability of industrial securities. The Indian capital market offers good potential for further expansion in terms of absorption of large capital flows. It is noteworthy that despite problems faced on account of irregularities in security transactions earlier this year, the Indian stock markets have shown creditable business resilience and recovery. As per the review published by Fortune International in its Autumn Special 1992 number, the Indian capital market has appreciated by 44 per cent in US dollar terms an appreciation rate which was second only to that of the Philippines at 71%. Comparable statistics for other emerging markets are: South Korea (–)24 per cent, Indonesia (–) 5 per cent, Singapore 5 per cent, Malaysia 9 per cent, Hong Kong 39 per cent, etc. It is true that the price-earning ratio of 29 is comparatively high when compared with the prevailing ratios in the afore-mentioned markets. But it needs mention that in the Indian market, the PE ratio is influenced to a very large extent by 4 or 5 leading scrips. If one leaves out these scrips, the PE ratio would certainly compare favourably with those prevailing in other emerging markets. In fact, considering that active trading is confined to few hundred scrips, it is conceivable that with substantial inflow of foreign capital, many of the currently dormant scrips, mainly of medium- sized corporate bodies, would show growth potential.



There are a couple of areas where some improvement will be necessary. The first is the factor of a long time between the transaction and the actual registration of transfer of securities at present. Secondly, the reporting and controlling system will have to be geared up to ensure compliance with the stipulations regarding upper limit for investment in a domestic company (24%) and by a particular investor (5%). The Reserve Bank authorities confirm that steps are being taken to overcome these problems.

Following the recommendations of Chakravarty Committee Report, (1985) on Monetary System, the RBI during the year, began the auction of 182 days treasury bills in the money market. The objective of this measure has been to broad base the development of money market by introducing new instruments, create an active secondary market, bring the interest rates on treasury bills to the market level and gradually reduce the monetization of public debt.

The steady increase in the capital formation, which is slightly higher than the level of gross domestic savings, indicates that the development banks have been playing a significant promotional role in mobilizing resources and channeling savings

into productive investment. The enlargement of their coverage will definitely accelerate the growth process.

Over the years, the corporate sectors, share of internal resources increased from 31.9 per cent during the period 1985-86 to 1989-90 to 60.7 per cent during 2000-01 to 2004-05. As such, the dependence on market-based financing declined from 18.2 per cent to 8.6 per cent respectively. The share of capital market related instruments (Debentures and Equity capital) in total external financing, peaked at 26.0 per cent during 1990-91 to 1994-95. It was around 14.3 per cent in 2005-06.

As a result, the debt-equity ratio declined sharply from 88.4 per cent to 61.6 per cent during the same period. This has enabled to corporate sector to significantly improve their profitability and their resilience.

Indian capital market has the following special features:

- Greater reliance on debt instruments as against equity and in particular, borrowing from financial institutions.
- Issue of debentures specifically, convertible debentures with automatic or compulsory conversion into equity without the normal option given to investors.
- Floatation of Mega issues for the purpose of take over, amalgamation etc. and avoidance of borrowing from financial institutions for the fear of their discipline and conversion clause by the bigger companies, and this has now become optional.
- Avoidance of underwriting by some companies to reduce the costs and avoid scrutiny by the FIs. It has become optional now.
- Fast growth of mutual funds and subsidiaries of banks for financial services leading to larger mobilization of savings from the capital market.

Let's Sum Up

Learners this section encompasses capital markets which play a vital role in the financial services industry by facilitating the raising of capital through the issuance and trading of securities. This unit delves into the structure and function of capital markets, encompassing both equity and

debt markets. Students will explore the mechanisms of primary and secondary markets, the role of financial intermediaries, and the impact of regulatory bodies. Key topics include the classifications of capital market, structure, present Indian capital market scenario. The unit also covers the significance of capital markets in economic development and their influence on corporate finance strategies. Learners will gain insights into market dynamics, trading strategies, and the risks and returns associated with various financial instruments. By the conclusion of this unit, students will have a thorough understanding of how capital markets operate and their essential role in the broader financial ecosystem.

Check Your Progress

1. **What is a primary characteristic of capital markets?**
   A. Short-term fund raising
   B. Long-term fund raising
   C. No regulatory oversight
   D. Only for government bonds
2. **What is one of the primary functions of the capital market?**
   A. Providing short-term loans
   B. Facilitating long-term investment and growth
   C. Issuing currency
   D. Conducting monetary policy
3. **Who are the primary participants in the capital market?**
   A. Central banks and government entities
   B. Commercial banks and retail investors
   C. Issuers, investors, and intermediaries
   D. Foreign governments and NGOs
4. **How do secondary markets contribute to the capital market mechanism?**

A. By issuing new securities

B. By facilitating the trading of existing securities

C. By setting interest rates

D. By controlling the money supply

5. Which market is responsible for the initial sale of securities to the public?

A. Secondary market

B. Tertiary market

C. Primary market

D. Quaternary market

SECTION 2.6: STOCK EXCHANGE

We can describe the stock exchange as a market or a place where different types of securities are bought and sold. It not only deals in shares and debentures but also in various other types of securities issued by central, state and local governments as well as institutions like Unit Trust of India, Steel Authority of India, National Thermal Power Corporation, etc. Therefore, it is also called 'securities market' or 'securities t. exchange'. It is a secondary market of securities because only the securities already issued are allowed to be dealt with on the floor of a stock exchange. Under Sec. 2(3) of the securities contract (Regulations) Act of 1956 as "*anybody of individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities*".

2.6.1 Characteristics of Stock Exchange

❖ **Wide coverage**:

As the name suggests, it is a country wide stock exchange and has its access throughout the country.

❖ **No fixed location:**

As it is screen based, there is no need for any stock exchange floor and all the members of this market are able to transact through their computer terminals, sitting at their respective officers

- **Confidential trading:**

The identity of the members is withheld and transactions entered only through code numbers. Thus, the anonymity of trading members is kept

- **Transparency:**

There is total transparency in trading operations as the opening and closing prices are available for the investors. They are also able to see their orders being executed

- **Effective matching:**

Matching of orders is done immediately with the help of the system, i.e., buying and selling adjustments. The system also ensures best prices for securities throughout India. The computer network helps the trader to find a suitable match for its order and it waits till the match is located.

- **Borrowings made easy:**

For the debt instruments, the system helps by providing a suitable match with reasonable interest and period of repayment. This exposure is available throughout India for the sale of debt instruments

- **Settlement:**

Automated trade matching system ensures quick and efficient settlement of transaction

2.6.2 Functions of Stock Exchange

1. Ready and continuous market for securities

The stock exchange provides a ready and continuous market for existing securities. Anybody can buy or sell securities in the stock exchange during the business hours.

2. Evaluation of securities

It integrates the demand and supply of securities in an effective manner and determines the price for securities every now and then.

3. Safety of capital and fair dealing

The stock exchange transactions are made publicly under well-defined rules and regulations and byelaws. The members of the exchange are bound to obey the rules and regulations.

4. Agency for capital formation

The stock exchange plays an active role in the capital formation in the country. It creates the habit of saving, investing and risk bearing amongst the investing public.

5. Proper canalization of capital

Stock exchange directs the flow of savings into the most productive and profitable channels. Since market quotations for different securities are given wide publicity, the investors can invest their savings in the securities of profitable companies.

6. Regulation of company management

The companies which want to get their securities listed in the stock exchange should have to follow certain rules and fulfill certain conditions.

7. Facilities for speculation

Healthy speculation is essential to equate demand and supply of securities at different places. The stock exchange encourages healthy speculation and provides opportunities to shrewd businessmen.

8. Barometer of business progress

Stock exchanges act as a barometer of the business conditions in the country. Booms and depressions are reflected by the index of prices of various securities.

9. Ideal meeting place

A Stock Exchange provides an ideal and convenient meeting place and a common platform for sellers and buyers of securities. It is the nerve center where open offers and bids are made.

10. Mobilization of savings

The stock exchanges perform another important function in an economy, i.e. mobilization of public savings and canalization of the same for productive purposes.

11. Control on companies

The companies listing their securities in the stock market have to submit their annual report and audited balance sheet to the stock market. Thus, only genuine

companies can function and have the shares transacted. If not, such companies will be black listed and they will find it difficult to raise their capital.

2.6.3 Members of Stock Exchange

Only the members can make transactions on a stock exchange. A non – member can buy and sell securities through a member broker. In order to become member, a person must satisfy the qualification prescribed by the stock exchange. Members can act as broker and jobbers.

A broker is a commission agent who buys and sells securities on behalf of non – members. He executes the orders of his clients and earns commission from them.

On the other hand, jobber is an independent dealer in securities who buys and sells securities in his own name.

Thus the broker is a general practitioner working for commission while a jobber is a specialist dealing in certain types of securities. Broker's commission is usually fixed whereas the profit of the jobber is variable and uncertain.

2.6.4 Stock Exchanges in India

BOMBAY STOCK EXCHANGE

Trading in securities has been in vogue in India for a little over 200 years. Transactions were in loan securities of the East India Company. Rampant speculation was a common feature even during those times. The broking community prospered as there was high rise in prices which led to a share mania during 1861–65. This bubble burst in 1865 when the American Civil War ended. The brokers realized that investor confidence in securities market could be sustained only by organizing themselves into a regulated body with defined rules and regulations. This realization resulted in formation of "The Native Share and Stock Brokers' Association', in 1875.Later, it came to be known as Bombay Stock Exchange.

Bombay Stock Exchange is a voluntary, non-profit-making association of broker members, emerged as a premier stock exchange after 1960s. BSE dominated the Indian capital market by accounting for more than 60 per cent of the all-India turnover.

Until March 1995, BSE had an open outcry system of trading. On March 14, 1995, BSE turned to electronic trading whereby brokers trade by using computers. This system is known as the BSE on-line Trading System (BOLT). The introduction of BOLT helped in improving trading volumes, significantly reducing the spread between buy and sell orders, better trading in odd lot shares, fixed income instruments, and dealings in the renunciation of rights shares.

In 1995, BOLT was limited to Mumbai, whereas NSE was operating at the national level. As a result, BSE was losing countrywide business. On October 29, 1996, SEBI allowed BSE to use its BOLT system nationwide. By 2002, BOLT is spread over 399 centres with 1,463 VSATS (Very Small Aperture Terminals) and 2,347 TWSs (Trader Work Stations).BSE, later, set up a Central Depository System to dematerialize shares and promote demat trading.

THE NATIONAL STOCK EXCHANGE OF INDIA

The stock markets witnessed many institutional changes in the 1990s. One of them was the establishment of NSE, a modern stock exchange which brought with it the best global practices.

The NSE was incorporated in November 1992 with the following objectives.

- To establish a nationwide trading facility for equities, debt instruments, and hybrids.
- To ensure all investors all over the country equal access through an appropriate communication network.
- To provide a fair, efficient, and transparent securities market to investors through an electronic trading system.
- To enable shorter settlement cycles and book entry settlement system.
- To meet the current international standards of securities markets.

The Pherwani Committee, which mooted the settling up the NSE, wanted different trading floors linked through a technologically backed automated network thereby creating an exchange with a national network. However, instead of providing a common platform to all regional stock exchanges, NSE is competing with BSE and has created a problem of survival for other exchanges.

NSE, unlike other Indian stock exchanges, is a tax-paying company incorporated under the Companies Act, 1956. It has been promoted by leading financial institutions and banks to provide automated and modern facilities for trading, clearing and settlement of securities in a transparent, fair and open manner and with countrywide access.

The exchange is professionally managed in that the ownership and management of NSE are completely separated from the right to trade on the exchange. In order to upgrade the professional standards of the market intermediaries, the exchange lays stress on factors such as capital adequacy corporate structure, track record, and educational experience.

NSE's membership is always on tap and anyone who meets the eligibility criteria such as cash deposit and high net worth can become a member. A member, who wants to quit business, can do so freely and have all deposits back after meeting all liabilities.

TYPES OF DEALINGS IN A STOCK EXCHANGE

There are various types of dealings in stock exchanges. Let us now discuss about them briefly.

1. **Spot delivery contracts**: Such contracts are settled on the spot i.e., the delivery and payment are made on the day of the transaction itself or latest by the following day. It is not a common practice now-a-days.
2. **Ready delivery contracts**: Such contracts are settled within a short period of time. Usually the period allowed is twelve days and the settlement takes place on the following settlement day. No postponement is allowed in case of ready delivery contracts.
3. **Forward Delivery Contracts**: Such contracts are also due for settlement on the following settlement day but they can be postponed to the next settlement

day, if so desired. This facility is provided by the stock exchange only in those scrips which are included in the specified list (List A). Such transactions are meant for speculation where the buyer has no intention to take delivery and make payment. He simply covers it by another transaction and earns or loses the difference in prices.

2.6.5 Listing of Securities on a Stock Exchange

Listing implies that the securities have met the satisfaction of stock exchange authorities, in respect of certain prescribed standards of legality, security and work-manship. When a security is admitted to dealings on a stock exchange, it does not guarantee the soundness or profitability of the company, in any manner. It is also not a certificate of the stock exchange for consideration by the investors. However, it indirectly gives an impression to the investor that the quoted security can be considered for investment, as the issuing company has satisfied the management of the stock exchange by fulfilling the required conditions and that there is no concealment. Listing provides a reasonable basis upon which the investor may assure himself about the genuineness of the company.

Advantages of Listing: The main advantage of listing of securities is that the investor gets all the required information about the securities he wants to buy or sell. Certain other advantages of listing are:

- It provides a continuous market for securities.
- It enhances the prestige of the company.
- It provides an indirect check against manipulation of prices by the management.

From the point of view of a company, listing of securities is beneficial in two ways:

i) it enhances credit worthiness of the company, and

ii) it widens the market of the securities. From the point of view of investors, listing provides safety of dealing and liquidity.

But listing of securities of a company does not guarantee the financial soundness of a company. It also does not recommend the purchase of securities. It only indicates that

at the time of listing the company was legally incorporated and was solvent as a going concern. This creates a favourable climate for the securities listed.

2.6.6 Factors affecting prices in Stock Exchange

- ***Interest rate***: If there is a change in the rate of interest charged by banks on loans and overdrafts, there is a change in the speculative activities, and security prices also change as a consequence of it. Thus, if banks allow credit at lower interest rate, it may induce people to borrow money from banks and engage more in speculative activities to make profits. Hence, price of securities may go up as a result of speculative buying. However, if the interest on bank credit goes up, borrowing will be reduced and demand for securities will be relatively lower. Hence prices of securities will tend to go down.
- ***Activities of the financial institutions***: When financial institutions start buying securities on a large scale, prices tend to move up because it leads to high expectation among the public about the prospects of the company and there is increased demand all around. Similarly, if there is large scale selling of securities by financial institutions, the price tends to go down.
- ***Performance of the company***: The prospects of a company as regards future profits and dividend payment are often reflected in the rising or falling prices of its shares. This is because the profit earning capacity and expected dividend rates Influence the expectations of investors about the rate of return on investment and future rise in prices. If the prospects are good, there is increased demand for shares, and prices move up. On the contrary, if a company's performance in terms of profit earning and dividend payment slows an unsatisfactory trend, the price of its shares start declining due to reduced demand.
- ***Business cycles***: Business conditions are periodically found to be subject to prosperity and depression. Prices of securities continue to rise during prosperity as bull speculators are active and go on purchasing securities. However, when speculators are unable to meet their liabilities due to lack of adequate funds, they

are forced to bargain for sale as a result of which prices rapidly decline and cause a state of depression in the market.

- ***Changes in Board of Directors***: Sometimes, security prices change as a result of changes in the Board of Directors of particular companies. The death or resignation of a well known director may cause doubt or apprehension about the future prospects of the company concerned. In that situation, generally, there would be an adverse effect on the price of shares of that company.
- ***Sympathetic fluctuation***: The prices of securities traded in more than one stock exchange often change due to changes in another exchange. If the prices of some I securities fall in one stock exchange due to some particular reason, it leads to a decline in the prices of the same securities in other exchanges too. This happens due to immediate communication among speculators.
- ***Political events***: Changes in the composition of government, changes in international relations, conflicts and political upheavals and wars between nations are always found to cause changes in the securities prices. This is because conditions of business and industry are generally affected by political events.
- ***Changes in government policy***: The changes in government policy with regard to taxation, import-export, price controls, licensing, etc. also influence the prices of securities, For example, if government decides to exempt dividends from income tax, the share prices will go up. If, on the other hand, government decides to raise income tax rates on company profits, the prices may fall. In fact, these days the policy changes by the government have become a major cause for an upswing or a downswing in prices of shares.

2.6.7 Regulations and control of Stock Exchanges

The attention of the Government was drawn from time to time to the ills of stock markets as a result of which the Securities Contracts (Regulation) Act, was passed in 1956 to regulate and control stock market operations in the wider interests of the financial markets, institutions and the public. The main provisions of this Act are as follows:

- ✓ There shall be only one recognized stock exchange in one region. This will have a unitary control.
- ✓ Dealers and brokers outside the area of the recognised stock exchange will be licensed.
- ✓ A recognized stock exchange shall be entitled to frame its own bye-laws for regulation and control of contracts subject to the approval of the Central Government. The bye-laws may regulate
    - i. opening and closing of market;
    - ii. regulation of trading hours;
    - iii. establishment of clearing house;
    - iv. regulation of prohibition of blank transfer (now these are regulated by the Companies Act);
    - v. listing of securities on the stock exchange;
    - vi. regulation or prohibition of carry over or badla system;
    - vii. limitations on the volume of trading by members and on their open positions;
    - viii. fixing minimum and maximum prices for securities in emergencies; and
    - ix. Separation of functions of jobbers and brokers and regulation of tarawani (jobbing) business.
- ✓ The Central Government is empowered to make and amend bye-laws after consulting the governing bodies of these exchanges.
- ✓ Dealings in future are prohibited, since they are regarded as gambling contracts.
- ✓ The Central Government has a right to withdraw recognition to, or supersede, the governing body of the exchange in, abnormal situations.
- ✓ A recognized stock exchange must submit periodical returns relating to its affairs and give information as required by the Government from time to time.
- ✓ Central Government has wide powers relating to the listing of securities. It can compel any public limited company to list its securities. It can vary or set aside the refusal of a stock exchange to list securities on an appeal made by a company.

2.6.8 Over the Counter Exchange of India (OTCEI)

It is a Stock Exchange without a proper trading floor. All stock exchanges have a specific place for trading their securities through counters. But, OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange. This stock exchange is recognized under the Securities Contract (Regulation) Act and so all the stocks listed in this exchange enjoy the same benefits as other listed securities enjoy.

OTCEI has been incorporated under Section 25 of the companies Act. As a result of which the word limited 'not be need use since it is promoted for a common case of promoting the interest of small and medium companies. This privilege has been given to the company by the Central government. This company was promoted by a group of financial institutions owned by Government of India, consisting of UTI, ICICI, IDBI, SBI Capital Market, IFCI, LIC, GIC and CAN BANK financial Services.

Features of OTCEI:

- ✓ It is a national ring less and computerized exchange
- ✓ Stock and shares listed in other stock exchange will not be listed in the OTCEI and similarly stocks

  Listed in OTCEI will not be listed in stock exchanges.
- ✓ Minimum issued equity capital should be Rs.30 lakhs
- ✓ No company with the issued equity capital of more than Rs.25 crores is permitted for listing
- ✓ Members will be required to maintain a minimum base capital of Rs. 4 lakhs
- ✓ The network of counters links OTCEI members, located in different parts of the country
- ✓ Promoting savings and investments by offering easier avenues for raising capital

Advantages of OTCEI:

- ✓ It is the first screen based nationwide stock exchange in India to introduce market making.

- ✓ It is the only exchange to allow listing of companies with paid-up capital below Rs. 3 crore.
- ✓ It is the only exchange which allows companies with a trade record of less than 3 years to cap the market.
- ✓ The exchange has introduced a weekly settlement cycle which helps in early settlement of trades.
- ✓ It acts as a bench mark to value securities.
- ✓ It is an easier launch pad for IPO.
- ✓ It helps to make the informal market of trading a broader & more liquid market.

2.6.9 Procedure for dealing at Stock Exchange (Trading Mechanism or Method of Trading on a Stock Exchange)

Outsiders are not allowed to buy or sell securities at a stock exchange. They have to approach brokers. Dealings can be done only through brokers. They are the members of the stock exchange. The following procedure is followed for dealing at exchanges:

1. **Selection of a broker:** An individual cannot buy or sell securities directly at stock exchange. He can do so only through a broker. So he has to select a broker through whom the purchase or sale is to be made. The intending investor or seller may appoint his bank for this purpose. The bank may help to choose the broker.

2. **Placing an order**: After selecting the broker, the next step is to place an order for purchase or sale of securities. The broker also guides the client about the type of securities to be purchased and the proper time for it. If a client is to sell the securities, then the broker shall tell him about the favourable time for sale.

3. **Making the contract:** The trading floor of the stock exchange is divided into different parts known as trading posts. Different posts deal in different types of securities. The authorised clerk of the broker goes to the concerned post and

expresses his intention to buy and sell the securities. A deal is struck when the other party also agrees. The bargain is noted by both the parties in their note books. As soon as order is executed a confirmation memo is prepared and is given to the client.

4. **Contract Note:** After issue of confirmation memo, a contract note is signed between the broker and the client. This contract note will state the transaction fees (commission of broker), number of shares bought or sold, price at which they are bought or sold, etc.

5. **Settlement:** Settlement involves making payment to sellers of shares and delivery of share certificate to the buyer of shares after receiving the price. The settlement procedure depends upon the nature of the transactions. All the transactions on the stock exchange may be classified into two- ready delivery contracts and forward delivery contracts.

a. Ready delivery contract: A ready delivery contract involves the actual payment of the amount by the buyer in cash and the delivery of securities by the seller. A ready delivery contract is to be settled on the same day or within the time period fixed by the stock exchange authorities.

b. Forward delivery contracts: These contracts are entered into without any intention of taking and giving delivery of the securities. The traders in forward delivery securities are interested in profits out of price variations in the future. Such transactions are settled on the settlement days fixed by the stock exchange authorities. Such contracts can be postponed to the next settlement day, if both the parties agree between themselves. Such postponement is called 'Carry over' or 'badla'. Thus 'carry over' or 'badla' means the postponement of transaction from one settlement period to the next settlement period.

Let's Sum Up

Learners in this section contains stock exchange which has over 125 years of history in the Indian Stock Market. In this time, it has undergone

several modifications. There are now new players, markets, stock exchanges, trading methods, instruments, and participants. The world's most technologically advanced stock exchanges nowadays are the National Stock Exchange and the Bombay Stock Exchange. These are comparable to developed country stock exchanges. Larger volumes have resulted from the introduction of online systems and rolling settlement, which have facilitated quick trade and settlements.

Check Your Progress

1. **What is a stock exchange?**
   A. A place where government policies are discussed
   B. A marketplace for buying and selling securities
   C. An institution for providing loans
   D. A department of the central bank
2. **Which of the following is a primary function of a stock exchange?**
   A. Issuing new currency
   B. Facilitating the trading of existing securities
   C. Providing education loans
   D. Managing national savings accounts
3. **Who are the members of a stock exchange?**
   A. Government officials
   B. Only institutional investors
   C. Brokers and dealers
   D. Retail shop owners
4. **What is the primary feature of the Over the Counter Exchange of India (OTCEI)?**
   A. It only deals with government securities
   B. It provides a platform for smaller companies to trade
   C. It is a physical trading floor like traditional exchanges
   D. It offers only international stocks

5. Which document provides detailed information about a company's IPO?

A. Annual report

B. Prospectus

C. Trading receipt

D. Audit report

SECTION 2.7: SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

The Securities and Exchange Board of India was constituted as a non-statutory body on April 12, 1988 through a resolution of the Government of India.

The Securities and Exchange Board of India was established as a statutory body in the year 1992 and the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992) came into force on January 30, 1992.

2.7.1Objectives of SEBI

- To deal with development and regulation of stock market in India.
- To provide protection to the investors.
- Regulate and develop a code of conduct for brokers, merchant bankers, etc.
- To protect the interest of investors so that there is a steady flow of savings into the capital market.
- To regulate the securities market and ensure fair practices by the issuers of securities so that they can raise resources at minimum cost.
- To promote efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional.

2.7.2 Powers of SEBI

The SEBI has three main powers:

- **Quasi-Judicial:** SEBI has the authority to deliver judgments related to fraud and other unethical practices in terms of the securities market. This helps to ensure fairness, transparency, and accountability in the securities market.

- **Quasi-Executive:** SEBI is empowered to implement the regulations and judgments made and to take legal action against the violators. It is also authorized to inspect Books of accounts and other documents if it comes across any violation of the regulations.
- **Quasi-Legislative:** SEBI reserves the right to frame rules and regulations to protect the interests of the investors. Some of its regulations consist of insider trading regulations, listing obligations, and disclosure requirements. These have been formulated to keep malpractices at bay. Despite the powers, the results of SEBI's functions still have to go through the Securities Appellate Tribunal and the Supreme Court of India.

SEBI has been vested with the following powers:

- ✓ To file complaints in a court
- ✓ Power to call periodical returns form recognized stock exchanges.
- ✓ Power to call any information or explanation from recognized stock exchanges or their members.
- ✓ Power to direct enquiries to be made in relation to affairs of stock exchanges or their members.
- ✓ Power to grant approval to bye – laws of recognized stock exchanges.
- ✓ Power to make or amend bye- laws of recognized stock exchanges.
- ✓ Power to compel listing of securities by public companies
- ✓ Power to grant registration to market intermediaries.

2.7.3 Functions of SEBI

The main three functions are-

1. Protective Function
2. Regulatory Function
3. Development Function

1. Protective Functions

As the name suggests, these functions are performed by SEBI to protect the interest of investors and other financial participants.

It includes-

- Checking price rigging
- Prevent insider trading
- Promote fair practices
- Create awareness among investors
- Prohibit fraudulent and unfair trade practices

2. Regulatory Functions

These functions are basically performed to keep a check on the functioning of the business in the financial markets.

These functions include-

- Designing guidelines and code of conduct for the proper functioning of financial intermediaries and corporate.
- Regulation of takeover of companies
- Conducting inquiries and audit of exchanges
- Registration of brokers, sub-brokers, merchant bankers etc.
- Levying of fees
- Performing and exercising powers
- Register and regulate credit rating agency

3. Development Functions

This regulatory authority performs certain development functions also that include but they are not limited to-

- Imparting training to intermediaries
- Promotion of fair trading and reduction of malpractices
- Carry out research work
- Encouraging self-regulating organizations
- Buy-sell mutual funds directly from AMC through a broker

Other functions

- SEBI is primarily set up to protect the interests of investors in the securities market.
- It promotes the development of the securities market and regulates the business.

- SEBI provides a platform for stockbrokers, sub-brokers, portfolio managers, investment advisers, share transfer agents, bankers, merchant bankers, trustees of trust deeds, registrars, underwriters, and other associated people to register and regulate work.
- It regulates the operations of depositories, participants, custodians of securities, foreign portfolio investors, and credit rating agencies.
- It prohibits insider trading, i.e. fraudulent and unfair trade practices related to the securities market.
- It ensures that investors are educated on the intermediaries of securities markets.
- It monitors substantial acquisitions of shares and take-over of companies.
- SEBI takes care of research and development to ensure the securities market is efficient at all times.

2.7.4 Role of SEBI

This regulatory authority acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment for the financial market enthusiasts that facilitate the efficient and smooth working of the securities market. SEBI also plays an important role in the economy.

To make this happen, it ensures that the three main participants of the financial market are taken care of, i.e. issuers of securities, investors, and financial intermediaries.

1. Issuers of securities

These are entities in the corporate field that raise funds from various sources in the market. This organization makes sure that they get a healthy and transparent environment for their needs.

2. Investor

Investors are the ones who keep the markets active. This regulatory authority is responsible for maintaining an environment that is free from malpractices to restore the confidence of the general public who invest their hard-earned money in the markets.

3. Financial Intermediaries

These are the people who act as middlemen between the issuers and investors. They make the financial transactions smooth and safe.

Role of SEBI in Primary Market

The primary market is under the control of Securities and Exchange Board of India. Securities and Exchange Board of India has an important role to keep the primary market healthy and efficient. It has been taking several measures for the development of primary market in India. In the meantime it is attempting to protect the interest of investors. It is issuing guidelines in respect of new issues of securities in the primary market. The role being played by the Securities and Exchange Board of India in the primary market can be understood from the following points:

1. The prime objective of establishing Securities and Exchange Board of India was to protect the interests of investors in securities, promoting the development of, and regulating the securities markets.

2. The Securities and Exchange Board of India Act came into force on 30th January, 1992. With its establishment, all public issues are governed by the rules and regulations issued by Securities and Exchange Board of India.

3. Securities and Exchange Board of India was formed to promote fair dealing in issue of securities and to ensure that the capital markets function efficiently, transparently and economically in the better interests of both the issuers and investors.

4. The promoters should be able to raise funds at a relatively low cost. At the same time, investors must be protected from the unethical practices. Their rights must be safeguarded so that there is a ready flow of savings into the market.

5. There must be proper regulation and code of conduct and fair practice by intermediaries to make them competitive and professional. These are taken care of by Securities and Exchange Board of India. instrumental in bringing greater

transparency in capital issues. Under the umbrella of Securities and Exchange Board of India, companies issuing shares are free to fix the premium provided that adequate disclosure is made in the offer documents. Securities and Exchange Board of India has become a vigilant watchdog with the focus towards investor protection.

6. The Securities and Exchange Board of India introduced the concept of anchor investor on June 18, 2009 to enhance issuer's ability to sell the issue, generate more confidence in the minds of retail investors and better price discovery in the issue process. Anchor investors are qualified institutional buyers that buy a large chunk of shares a day before an IPO opens. They help arriving at an appropriate benchmark price for share sales and generate confidence in retail investors. A retail investor is one who can bid in a book-built issue or applies for securities for a value of not more than Rs.1,00,000.

Role of SEBI in Secondary Market:

Since its birth, Securities and Exchange Board of India has been playing an active role to make the secondary market healthy and efficient. It will issue guidelines for the proper functioning of the secondary market. It has the power to call periodical returns from stock exchanges. It has the power to prescribe maintenance of certain documents by the stock exchanges. It may call upon the exchange or any member to furnish explanation or information relating to the affairs of the stock exchange or any members.

2.7.5 Organizational structure of SEBI

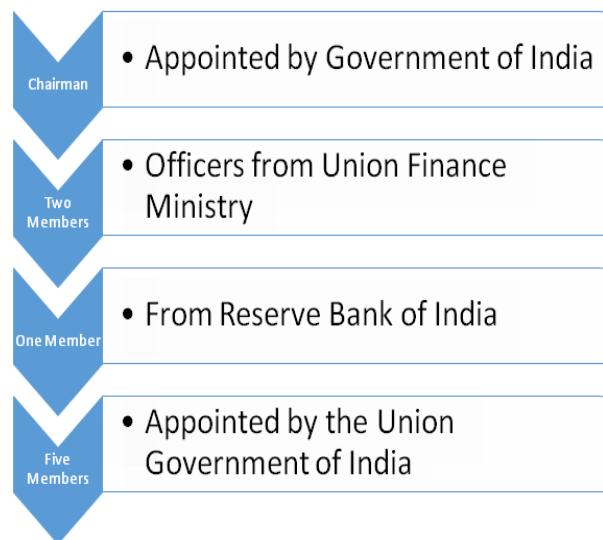
The SEBI act deals with establishment incorporation administration and management of the board of directors etc. The SEBI act provides for the establishment of a statutory board consisting of six members. The chairman and two members are to be appointed by the central government, one member to be appointed by the Reserve Bank and two members having experience of securities market to be appointed by the central government. Section II deals with the power of the board.

SEBI has divided its activities into four operational departments namely:

- ✓ Primary market department
- ✓ Issues management and Intermediaries department
- ✓ Secondary market department and
- ✓ Institutional department

The SEBI Board consists of nine members-

1. One Chairman appointed by the Government of India
2. Two members who are officers from Union Finance Ministry
3. One member from Reserve Bank of India
4. Five members appointed by the Union Government of India



Let's Sum Up

Learners this section contains about SEBI (Securities and Exchange Board of India) which is a pivotal regulatory authority overseeing the securities market in India. This unit provides an in-depth understanding of SEBI's role, functions, and regulatory framework. Learners will explore SEBI's mandate to protect investor interests, promote fair trading practices, and ensure the orderly development of the securities market. Key topics include SEBI's guidelines for market intermediaries, its enforcement

actions, and its initiatives to enhance market transparency and integrity. By the end of this unit, students will have a comprehensive understanding of SEBI's critical role in the financial services industry and its contribution to maintaining a robust and fair marketplace.

Check Your Progress

1. **What does SEBI stand for?**
   A. Securities and Exchange Board of India
   B. Securities and Economic Bureau of India
   C. Stock Exchange Bureau of India
   D. Securities and Equities Board of India
2. **Which of the following is an objective of SEBI?**
   A. Protecting the interests of investors in securities
   B. Regulating the insurance sector
   C. Managing public sector enterprises
   D. Issuing government bonds
3. **Which of the following powers does SEBI possess?**
   A. Formulate regulations for securities market
   B. Enforce criminal laws
   C. Collect taxes
   D. Conduct elections
4. **A key function of SEBI is to:**
   A. Act as a banker to the government
   B. Regulate the functioning of stock exchanges
   C. Manage the country's fiscal policy
   D. Oversee the functioning of the central bank
5. **SEBI plays a crucial role in:**
   A. Providing insurance coverage
   B. Educating investors about market risks
   C. Regulating agricultural markets

D. Issuing passports

2.8 Unit Summary

This unit provides a comprehensive overview of several key components in the financial services sector, including merchant banking, issue management, capital markets, stock exchanges, and the role of the Securities and Exchange Board of India (SEBI). Merchant banking involves providing financial services and advisory, including underwriting, fundraising, mergers and acquisitions, and portfolio management. Learners will learn about the functions, importance, and regulatory environment governing merchant banks. Issue management focuses on the process of raising capital by issuing securities. This section covers the stages of issue management, the roles of various intermediaries, regulatory requirements, and the methods of public offerings such as Initial Public Offerings (IPOs) and Follow-on Public Offerings. The capital market is essential for economic development, providing a platform for raising long-term funds through the trading of securities. This segment explores the structure and functioning of capital markets, including primary and secondary markets, and the roles of equity and debt instruments. Stock exchanges are organized markets for buying and selling securities. Learners will study the mechanisms of stock exchanges, trading processes, listing requirements, and the role of exchanges in ensuring market liquidity and transparency. The Securities and Exchange Board of India (SEBI) regulates and oversees the securities market in India. Through a blend of theoretical knowledge and practical case studies, students will gain a holistic understanding of these critical elements in the financial services industry, and how they interrelate to support market stability and growth.

2.9 Glossary

KEYWORDS	MEANING
Foreign exchange	Foreign exchange, or forex, is the conversion of one country's currency into another. In a free economy, a country's currency is valued according to the laws of supply and demand.

Portfolio Management	Portfolio management is the art and science of selecting and overseeing a group of investments that meet the long-term financial objectives and risk tolerance of a client, a company, or an institution.
Working Capital	Working capital is a financial metric that is the difference between a company's curent assets and current liabilities.
Credit Syndication	Credit Syndication refers to obtaining of loans from single development finance institution or a syndicate or consortium.
SWAP	A swap is a derivative contract through which two parties exchange the cash flows or liabilities from two different financial instruments.
Basis of Allotment (BOA)	The Basis of Allotment (BOA) is the process that decides the share allocation in an IPO to the investors who have applied for it.
Initial Public Offering (IPO)	An Initial Public Offering (IPO) is when a private company offers its shares to the public for the first time. This allows the company to raise funds by selling ownership stakes to individuals and institutional investors.
Speculation	The act of purchasing an asset (a commodity, good or real estate) that has a substantial risk of losing value but also holds the hope of gaining value in the near future.
Carry forward / Badala	Provide the facility for carrying forward the transactions from one settlement to another settlement.
Stock Market Index	It is barometer of market behaviour and it reflects market directions. It is also an indicator of day-to-day fluctuations in stock prices.
Scrips	Securities like shares, debentures, bonds, etc.

2.10 Self-Assessment Questions

Short Answers: (5 Marks)

1. What is merchant banking? Explain the scope of merchant banking in India.
2. Describe the functions of the merchant bankers.
3. State the difference between commercial banking and merchant banking.
4. Explain the role of merchant banking in public issue.
5. What are the advantages and disadvantages of new issue market?
6. Discuss the floating of new issues in the primary market?
7. Who are the parties involved in the new issue market?
8. Describe the marketing of new issues.
9. What is underwriting? Explain the functions of underwriting.
10. Define capital market. What are the functions of capital market?
11. Discuss the capital market structure.
12. What are the functions of stock exchange?
13. Enumerate the factors affecting prices in stock exchange.
14. Briefly explain OTCEI.
15. Describe the powers of SEBI.
16. Explain the role of SEBI in capital market.

Long Answers: (8 Marks)

1. What is issue management? Describe the pre-issue and post-issue management activities pertaining to the issue.
2. List and explain the types of underwriting. Briefly elaborate the merits and demerits of underwriting.
3. Classify the types of capital market and briefly explain its types.
4. Briefly elaborate the current Indian Capital market.
5. Explain the stock exchanges in India.
6. Describe the regulation and control of stock exchanges.
7. Describe the trading mechanism on a stock exchange in detail.
8. What are the functions of SEBI? Briefly discuss.

2.11 Case Study

Rajesh is the CEO of a leading petrochemical company. Recently the company issued equity to meet some costs. However to meet the floatation costs incurred to issue equity the company decided to do Bridge Financing. So it decided to issue a type of money market instrument. The requirement of the company was met intelligently by good decision of its wise CEO. Three months later the company decided to issue a new equity again for the first time in the primary market. According to the method of floatation it involved it decided to go for the method adopted mostly by the public companies and made an appeal to the masses by directly approaching them. Again the success comes the way of the company and its objectives are achieved. However when the same type of attempt was made by the company again after another three months the company had a lot of problem. The problem was about deciding one key aspect related to the new issued security. The company would not have cared much about this key aspect if the same process would have taken place in the secondary market.

Questions:

1. Which type of money market instrument was issued by the company in the earlier part?
2. Which method of floatation was adopted by the company three months later?
3. What key aspect the company would not have cared about in the secondary market?

2.12 Answers for Check Your Progress

Modules	S.No.	Answers
Module 1	1.	B. Offering investment and advisory services for large transactions
	2.	C. Offering personal loans
	3.	B. Underwriting securities
	4.	B. Securities and Exchange Board of India (SEBI)
	5.	C. Facilitating international trade
Module 2	1.	C. A systematic approach to handling problems
	2.	E. Private Placement

	3.	B. Preparing the draft prospectus
	4.	B. Merchant bankers
	5.	B. Regulatory authorities and stock exchanges
Module 3	**1.**	C. Raising capital for the company
	2.	B. Preparing the prospectus
	3.	C. Facilitating trading of existing securities
	4.	C. Access to a large pool of capital
	5.	C. Public issue
Module 4	**1.**	B. The assessment of risk involved in an investment
	2.	C. Underwriters and issuers
	3.	A. Marketing the securities
	4.	C. Syndicate underwriting
	5.	B. To evaluate and take on the risk of distributing the securities
Module 5	**1.**	B. Long-term fund raising
	2.	B. Facilitating long-term investment and growth
	3.	C. Issuers, investors, and intermediaries
	4.	B. By facilitating the trading of existing securities
	5.	C. Primary market
Module 6	**1.**	B. A marketplace for buying and selling securities
	2.	B. Facilitating the trading of existing securities
	3.	C. Brokers and dealers
	4.	B. It provides a platform for smaller companies to trade
	5.	B. Prospectus
Module 7	**1.**	A. Securities and Exchange Board of India

	2.	A. Protecting the interests of investors in securities
	3.	A. Formulate regulations for securities market
	4.	B. Regulate the functioning of stock exchanges
	5.	B. Educating investors about market risks

2.13 Suggested Readings

- "Capital Market and Financial System in India" by V. A. Avadhani
- "Merchant Banking and Financial Services" by Dr. S. Gurusamy
- "Fundamentals of the Capital Market" by K. Natarajan
- "Financial Markets and Institutions" by Frederic S. Mishkin and Stanley G. Eakins

2.14 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Merchant Banking	https://www.youtube.com/watch?v=aegDC0hLPoc&list=PLHYCaCCmyrnZ97kb7U9mFhv9M1QIz_nHF
2.	Capital market	https://www.youtube.com/watch?v=L8uQV8dmG8g
3.	Stock Exchange	https://www.youtube.com/watch?v=KrcacISG4ek

2.15 References

- Financial Institutions and Markets – L M Bhole, The McGraw-Hill Companies.
- Financial Markets and Services – Gordon & Natarajan, Himalaya Publishing House.
- Banking &financial institutions - K.K.Jindal
- Indian Financial System by Bharati V.Pathak.

UNIT 3 - LEASING, HIRE PURCHASE & FACTORING

Leasing and Hire purchase – Concepts and features – Types of lease Accounts. Factoring – Functions of Factor

By the end of this unit, learners will be able to understand leasing**,** define leasing and differentiate between various types of leases (operating, finance, and sale-and-leaseback). Explain the benefits and drawbacks of leasing for both lessees and lessors. Comprehend Hire Purchase**,** define hire purchase agreements and distinguish them from leasing. Explore factoring and **e**xplain the roles and responsibilities of factors and the benefits of factoring for businesses.

SECTION 3.1: LEASING

A lease is an agreement under which a firm acquires a right to make use of a capital asset like machinery etc. on payment of an agreed fee called lease rentals. The person (or the company) which acquires the right is known as lessee. He does not get the ownership of the asset. He acquires only the right to use the asset. The person (or the company) who gives the right is known as lessor.

Meaning of leasing:

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments. The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent.

Lease can be defined as the following ways:

- A contract by which one party (lessor) gives to another (lessee) the use and possession of equipment for a specified time and for fixed payments.
- The document in which this contract is written.
- A great way companies can conserve capital.

- An easy way vendor can increase sales.

A lease transaction is a commercial arrangement whereby an equipment owner or Manufacturer conveys to the equipment user the right to use the equipment in return for a rental. In other words, lease is a contract between the owner of an asset (the lessor) and its user (the lessee) for the right to use the asset during a specified period in return for a mutually agreed periodic payment (the lease rentals). The important feature of a lease contract is separation of the ownership of the asset from its usage.

3.1.1 Characteristics of lease

- **Parties to lease agreement:** There are two parties to lease agreement. They are lessor and the lessee. Lessor is a person who conveys to another person the right to issue an asset in consideration of a periodical rental payment, under a lease agreement. Lessee is a person who obtains, the right to use the asset form the lessor for periodical rental payment for an agreed period of time.
- **Lease asset:** Leasing is used for financing the use of fixed assets of high value. The asset is the property to be leased out. It may include an automobile, an aircraft, plant and machinery, a building etc. However the ownership of asset is separated from the use of the asset. During the period of the lease, the ownership of the asset rest with the lessor while the use is transferred to the lease.
- **Lease term:** The term of the lease is called the lease period. It is the period for which agreement is in operation. It is illegal to have a lease without a specified term. Sometime the lease period may be broken into primary lease period and secondary lease period. A primary lease period is a period during which the lessor harts to get back in investment together with interest. A secondary period comprises the later part of the lease period, where only nominal rentals are charged in order to keep the lease agreement operational.
- Lease rentals: Lease rental constitute the consideration payable by the lessees as specified in the lease transaction. Rentals are determined to cover such costs as interest on the lessor’s investment cost of any repairs and maintenance that are part

of the lease package, depreciation on the leased asset, and any other service charge in connection with lease.

3.1.2 Importance of lease financing

Lease financing is based on the observation made by Donald B. Grant: "Why own a cow when the milk is so cheap? All you really need is milk and not the cow."

Leasing industry plays an important role in the economic development of a country by providing money incentives to lessee. The lessee does not have to pay the cost of asset at the time of signing the contract of leases. Leasing contracts are more flexible so lessees can structure the leasing contracts according to their needs for finance. The lessee can also pass on the risk of obsolescence to the lessor by acquiring those appliances, which have high technological obsolescence. Today, most of us are familiar with leases of houses, apartments, offices, etc.

3.1.3 Advantages and limitations of lease financing

The advantages of leasing include:

- Leasing helps to possess and use a new piece of machinery or equipment without huge investment.
- Leasing enables businesses to preserve precious cash reserves.
- The smaller, regular payments required by a lease agreement enable businesses with limited capital to manage their cash flow more effectively and adapt quickly to changing economic conditions.
- Leasing also allows businesses to upgrade assets more frequently ensuring they have the latest equipment without having to make further capital outlays.
- It offers the flexibility of the repayment period being matched to the useful life of the equipment.

- It gives businesses certainty because asset finance agreements cannot be cancelled by the lenders and repayments are generally fixed.
- However, they can also be structured to include additional benefits such as servicing of equipment or variable monthly payments depending on a business's needs.
- It is easy to access because it is secured – largely or entirely – on the asset being financed, rather than on other personal or business assets.
- The rental, which sometimes exceeds the purchase price of the asset, can be paid from revenue generated by its use, directly impacting the lessee's liquidity.
- Lease installments are exclusively material costs.
- Using the purchase option, the lessee can acquire the leased asset at a lower price, as they pay the residual or non-depreciated value of the asset.
- For the national economy, this way of financing allows access to state-of-the-art technology otherwise unavailable, due to high prices, and often impossible to acquire by loan arrangements.

Limitations of leasing:

- It is not a suitable mode of project financing because rental is payable soon after entering into lease agreement while new project generate cash only after long gestation period.
- Certain tax benefits/ incentives/subsidies etc. may not be available to leased equipments.
- The value of real assets (land and building) may increase during lease period. In this case lessee may lose potential capital gain.
- The cost of financing is generally higher than that of debt financing.

- A manufacturer (lessee) who want to discontinue business need to pay huge penalty to lessor for pre-closing lease agreement
- There is no exclusive law for regulating leasing transaction.
- In undeveloped legal systems, lease arrangements can result in inequality between the parties due to the lessor's economic dominance, which may lead to the lessee signing an unfavourable contract.

3.1.4 Types of lease

The following are the types of lease:

1) Financial lease

Long-term, non-cancellable lease contracts are known as financial leases. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. At lease it must give an option to the lessee to purchase the asset he has used at the expiry of the lease. Under this lease the lessor recovers 90% of the fair value of the asset as lease rentals and the lease period is 75% of the economic life of the asset. The lease agreement is irrevocable. Practically all the risks incidental to the asset ownership and all the benefits arising there from are transferred to the lessee who bears the cost of maintenance, insurance and repairs. Only title deeds remain with the lessor. Financial lease is also known as ‘capital lease’. In India, financial leases are very popular with high-cost and high technology equipment. According to the International Accounting Standard (IAS) “a financial lease is a lease that transfers substantially also the risks and rewards incident to ownership of an asset. TITLE may or may not eventually be transferred”.

a. Full payout lease:-

In this type of lessee, the lessor recovers the full value of the leased asset, within the period of the lease, by way of lease rental and the residual value.

b. True lease:

In this type of lease, the typical tax-related benefits such as investment tax credit, depreciation tax shields etc are offered to the lessor.

2) Operational lease

An operating lease stands in contrast to the financial lease in almost all aspects. This lease agreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Mines, Computers hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets.

3) Sale and lease back

It is a sub-part of finance lease. Under this, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of lease rentals.

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 depreciation but appreciation, say land. The advantage of this method is that the lessee can satisfy himself completely regarding the quality of the asset and after possession of the asset convert the sale into a lease arrangement.

4**) Leveraged leasing**

Under leveraged leasing arrangement, a third party is involved beside lessor and lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and the asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset is entitled to depreciation allowance associated with the asset.

5) Direct leasing

Under direct leasing, a firm acquires the right to use an asset from the manufacture directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc.

Differences between financial lease and operating lease:

- While financial lease is a long term arrangement between the lessee (user of the asset) and the owner of the asset, whereas operating lease is a relatively short term arrangement between the lessee and the owner of asset.
- Under financial lease all expenses such as taxes, insurance are paid by the lessee while under operating lease all expenses are paid by the owner of the asset.
- The lease term under financial lease covers the entire economic life of the asset which is not the case under operating lease.
- Under financial lease the lessee cannot terminate or end the lease unless otherwise provided in the contract which is not the case with operating lease where lessee can end the lease any time before expiration date of lease.
- While the rent which is paid by the lessee under financial lease is enough to fully amortize the asset, which is not the case under operating lease.

3.1.5 Regulatory framework for leasing in India

As there is no separate statue for leasing in India, the provisions relating to bailment in the Indian Contract Act govern equipment leasing agreements as well section 148 of the Indian Contract Act defines bailment as:

“The delivery of goods by one person to another, for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed off according to the directions of the person delivering them. The person delivering the goods is called the ‘bailor’ and the person to whom they are delivered is called the ‘bailee’.

Since an equipment lease transaction is regarded as a contract of bailment, the obligations of the lessor and the lessee are similar to those of the bailor and the bailee (other than those expressly specified in the least contract) as defined by the provisions of sections 150 and 168 of the Indian Contract Act. Essentially these provisions have the following implications for the lessor and the lessee.

- The lessor has the duty to deliver the asset to the lessee, to legally authorise the lessee to use the asset, and to leave the asset in peaceful possession of the lessee during the currency of the agreement.
- The lessor has the obligation to pay the lease rentals as specified in the lease agreement, to protect the lessor's title, to take reasonable care of the asset, and to return the leased asset on the expiry of the lease period.

Contents of a lease agreement:

The lease agreement specifies the legal rights and obligations of the lessor and the lessee. It typically contains terms relating to the following:

1. Description of the lessor, the lessee, and the equipment.
2. Amount, time and place of lease rentals payments.
3. Time and place of equipment delivery.
4. Lessee's responsibility for taking delivery and possession of the leased equipment.
5. Lessee's responsibility for maintenance, repairs, registration, etc. and the lessor's right in case of default by the lessee.
6. Lessee's right to enjoy the benefits of the warranties provided by the equipment manufacturer/supplier.
7. Insurance to be taken by the lessee on behalf of the lessor.
8. Variation in lease rentals if there is a change in certain external factors like bank interest rates, depreciation rates, and fiscal incentives.
9. Options of lease renewal for the lessee.
10. Return of equipment on expiry of the lease period.
10. Arbitration procedure in the event of dispute.

3.1.6 Problems of leasing in India

Leasing has great potential in India. However, leasing in India faces serious handicaps which may bar its growth in future. The following are the some of the problems.

1. Unhealthy competition – There is over supply of lessor in India. The stiff competition between these lessors are force them to reduce their profit margin to bare minimum level. More over subsidiaries of banks and financial institution have competitive edge over private sector lessor due their cheap source of finance.

2. Lack of qualified personnel- leasing requires qualified and experienced personnel at the helm of its affairs. In India, leasing is of recent one and hence it is difficult to get right man to deal with leasing business.

3. Tax Consideration- In reality, the lessee's tax shelter is lessors' burden. The lease becomes economically viable if lessors effective tax rate is low. More over taxes like sale tax, wealth tax, additional tax, surcharge etc., add to the cost of leasing. It makes leasing relatively more expensive

4. Stamp Duty- States treats the leasing transaction as a sale for the purpose of making them eligible to sales tax. On the contrary, for stamp duty, the transaction is treated as pure lease transactions. Accordingly heavy stamp duty imposed on lease document.

5. Delayed payment and bad debts- The problem of delayed payment of rents and bad debts add to the cost of lease. This problem would disturb prospects of leasing business.

Let's Sum Up

Learners this section holds about leasing which is a vital financial service that allows businesses to use assets without the need for immediate full ownership. This unit covers the fundamentals of leasing, including the different types of leases such as operating and finance leases. Learners will explore the benefits and drawbacks of leasing from both the lessee's and lessor's perspectives. The unit also delves into the regulatory framework and problems of leasing in India. By understanding leasing, students will learn how this financing option can help businesses manage capital, mitigate risks, and enhance operational flexibility.

Check Your Progress

1. **What is leasing?**
   A) Buying an asset
   B) Renting an asset
   C) Selling an asset
   D) Disposing of an asset
2. **Which of the following is a characteristic of a lease?**
   A) Transfer of ownership
   B) Temporary use of an asset
   C) Permanent disposal of an asset
   D) Exchange of goods
3. **Which of the following is an advantage of lease financing?**
   A) High initial cost
   B) Depreciation benefits
   C) Flexibility in asset management
   D) Ownership of the asset
4. **Which of the following is an advantage of lease financing?**
   A) High initial cost
   B) Depreciation benefits
   C) Flexibility in asset management
   D) Ownership of the asset
5. **What is one of the problems of leasing in India?**
   A) Lack of demand for leased assets
   B) High asset acquisition costs
   C) Complex regulatory requirements
   D) Overabundance of lessors

SECTION 3.2: HIRE PURCHASE

Hire purchase is an alternative to leasing. Hire purchase is a transaction where goods are purchased and sold on the condition that payment is made in installments. The buyer gets only possession of goods. He does not get ownership. He gets ownership only after the payment of the last installment. If the buyer fails to pay any installment, the seller can repossess the goods. Each installment includes interest.

3.2.1 Definition of Hire Purchase

A transaction of finance whereby goods are bought and sold as per the terms and conditions specified below is known as 'hire purchase finance'.

1. Payment of periodic installments
2. Immediate possession of goods by the buyer
3. Ownership of goods remaining with the vendor until the payment of the last installment
4. Vendor's right to repossess the goods in the event of default committed by the buyer
5. Treatment of each installment as hire charge till the payment of the last installment.

According to the Hire Purchase act of 1972, the term 'hire purchase' is defined as, " an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement, and includes agreement under which:

- Possession of goods is delivered by the owner thereof to a person on the condition that such person pays the agreed amount in periodic payments
- The property of the goods is to pass to such a person's on the payment of the last of such installment
- Such a person has a right to terminate the agreement any time before the property so passes"

Rights of Hirer

The Hire Purchase Act of 1972 provides the following rights to the hirer:

- **Right of Protection**

It is not possible for the hire vendor to terminate the hire purchase agreement on account of default in payment of hire charges by the hirer or due to unauthorized act or breach of express conditions, unless the hire vendor gives notice in writing to the hirer in this regard.

- **Right of Notice**

When the hire charges are weekly, or for a period less than that, one week notice is to be given, and in all other cases a two weeks' notice is to be given.

- **Right of Repossession**

The right of repossession is not available to the hire vendor, unless sanctioned by the court in the following cases:

a) One half of the price has been paid where the hire purchase price is less then Rs.15,000 (Rs.5,000 in the case of motor vehicles)

b) Three fourth of the price has been paid where the hire purchase price is not less than Rs.15,000 (Rs.5,000 in the case of motor vehicles)

c) Three fourth or such higher proportions, not exceeding nine-tenth, where the hire purchase price is not less than Rs.15, 000.

- **Right of Statement**

The hirer has the right to obtain a statement on payment of Re.1, containing details such as the amount paid by the hirer, the amount and the date upon which the installment becomes due but has not been paid, the amount of installment, which will become payable, etc.

- **Right to Excess Amount**

The hirer has the right to obtain any amount in excess of the value of goods repossessed, over and above the amount of installments payable by the hirer, in the event of a default.

3.2.2 Features of Hire Purchase

The main features of a hire purchase agreement are as below:

- The payment is to be made by the hirer (buyer) to the hiree, usually the vendor, in installments over a specified period of time.
- The possession of the goods is transferred to the buyer immediately.
- The property in the goods remains with the vendor (hiree) till the last installment is paid. The ownership passes to the buyer (hirer) when he pays all installments.
- The Hiree or the vendor can repossess the goods in case of default and treat the amount received by way of installments as hire charged for that period.
- The installments in hire purchase include interest as well as repayments of principal.
- Usually, the hiree charges interest on flat rate.

3.2.3 Advantages and disadvantages of Hire Purchase

Hire purchase as a source of finance has the following advantages:

- Financing of an asset through hire purchase is very easy.
- Hire purchaser becomes the owner of the asset in future.
- Hire purchaser gets the benefit of depreciation on asset hired by him/her.
- Hire purchasers also enjoy the tax benefit on the interest payable by them.
- Immediate use of assets without paying the entire amount.
- Expensive assets can be utilized as the payment is spread over a period of time.
- Fixed rental payments make budgeting easier as all the expenditures are known in advance.
- Easy accessibility as it is a secured financing.
- No need to worry about the asset depreciating quickly in value as there is no obligation to buy the asset.

Disadvantages of Hire Purchase:

Hire purchase financing suffers from following disadvantages:

- Ownership of asset is transferred only after the payment of the last installment.
- The magnitude of funds involved in hire purchase are very small and only small types of assets like office equipment’s, automobiles, etc., are purchased through it.
- The cost of financing through hire purchase is very high.

- The addition of any covenants increases the cost.
- If the hired asset is no longer needed because of any change in the business strategy, there may be a resulting penalty.
- Total amount paid towards the asset could be much higher than the cost of the asset due to substantially high-interest rates.

3.2.4 Types of Hire Purchase

- **Consumer Hire Purchase:** In this type, the goods are hired by the buyer for non-business purposes i.e. for his personal use. This can also be for family or other household purposes apart from the business. The hirer here is not the business but the natural person.
- **Industrial Hire Purchase:** Contrary to the above, here, the hirer is not the natural personnel but the companies or the industries that take the goods on hire for their business purposes. Example: the hire purchase of machinery for use in industries.

3.2.5 Difference between Leasing and Hire Purchase

Basis	Hire Purchasing	Leasing
Meaning	Hire Purchasing involves acquiring an asset through a series of installment payments over a specified period.	Leasing involves renting an asset from the owner (lessor) for a specified period in exchange for periodic payments.
Duration	Duration of hire purchasing are longer months to years.	Duration of leasing are shorter and customizable.
Ownership Transfer	In hire purchasing, the buyer gets ownership of the asset after completing paying installments.	In leasing, the owner remains the same throughout the lease period.

Basis	Hire Purchasing	Leasing
Payment Structure	With hire purchasing, the buyer pays installments until they own the asset.	In leasing, the lessee makes regular payments to use the asset for a set time.
Maintenance and Insurance	In hire purchasing, the buyer is responsible for maintenance and insurance.	In leasing, the owner usually handles maintenance and upkeep.
Flexibility	Hire purchasing terms are often fixed once agreed upon, offering less flexibility.	Leasing is more flexible; lessees can often change terms or upgrade assets.
Tax Treatment	Interest portion of hire purchase payments may be eligible for tax deductions as a business expense.	Lease payments may be treated as operating expenses and deducted from taxable income.
End of Term Options	With hire purchasing, ownership is gained, and no more payments are needed.	Leasing allows options like buying, returning, or renewing the lease at the end.
Risk Exposure	In hire purchasing, the buyer takes on the risk of asset depreciation or damage.	In leasing, the owner retains ownership and risk.
Contract Termination	Hirer purchase can terminate before ownership (subject to fees).	Breaking a lease can have legal consequences.

Let's Sum Up

Learners this section contains hire purchase which is a financial arrangement where an individual or business acquires an asset by making an initial down payment followed by regular instalments. Ownership of the asset transfers to the buyer only after all payments are completed. This unit

explores the benefits and drawbacks of hire purchase agreements, highlighting its role in facilitating asset acquisition without the need for substantial upfront capital. Learners will learn about the advantages, such as improved cash flow management and tax benefits, as well as limitations, including higher overall costs and the risk of repossession. By understanding hire purchase, students will be equipped to evaluate its suitability as a financing option in various financial contexts.

Check Your Progress

1. **What is a hire purchase agreement?**
   A) Immediate purchase with full payment
   B) Acquisition of goods through installment payments
   C) Short-term rental of goods
   D) Leasing of services
2. **Which of the following is a right of the hirer in a hire purchase agreement?**
   A) To sell the asset before completing all payments
   B) To use the asset as per the agreement terms
   C) To transfer the ownership immediately
   D) To cancel the agreement without any penalty
3. **What is a key feature of hire purchase agreements?**
   A) Immediate transfer of ownership
   B) Payment in installments with interest
   C) No down payment required
   D) Asset becomes an immediate liability
4. **What is a disadvantage of hire purchase?**

A) Immediate use of the asset

B) Increased overall cost due to interest

C) Flexibility in asset usage

D) Tax benefits on installments

5. What distinguishes hire purchase from leasing?

A) Transfer of ownership upon final payment in hire purchase

B) Regular payments in leasing

C) Asset use without ownership in hire purchase

D) Long-term use in both

SECTION 3.3: FACTORING

The word factor has been derived from the latin word "facere" which means to make or do or to get things done. Factoring originate in countries like USA, UK, France etc., A financial service, where by an institution called the factor undertakes the task of realizing accounts receivables such as book debts, bills receivables, and managing sundry debts an sales registers of commercial and trading firms us the capacity of the agent, for a commission is known as factoring.

Definition:

C.S.Kalyansundaram in his report (1988) submitted to the R B defines factoring as, " a continuing arrangement under which a financing institution assumes the credit and collection function for its client, purchase receivables as they arise maintains the sales ledger, attends to other book keeping duties relating to such accounts, and performs other auxiliary functions. Where, specialized financial institutions were established to assist firms in meeting their working capital requirements by purchasing their receivables.

3.3.1 Mechanism

Under the factoring arrangement, the seller does not maintain a credit or collection department. The job instead is handed over to a specialized agency called the factor. After each sale, a copy of the invoice and delivery challan, the agreement and other related papers are handed over to the factor.

- ✓ An agreement is entered into between the selling firm and the factor firm. The agreement provides the basis and the scope of the understanding reached between the two for rendering factor services
- ✓ The sales documents should contain the instructions to make payments directly to the factor who is assigned the job of collection of receivables.
- ✓ When the payment is received by the factor, the account of the selling firm is credited by the factor after deducting its fees, charges, interest etc. as agreed.
- ✓ The factor may provide advance finance to the selling firm if the conditions of the agreement so require.

3.3.2 Functions of factors

- **Credit Cover**: The factor takes over the risk burden of the client and thereby the client's credit is covered through advances.
- **Case advances**: The factor makes cash advances to the client within 24 hours of rece iving the documents.
- **Sales ledgering**: As many documents are exchanged, all details pertaining to the transaction are automatically computerized and stored.
- **Collection Service**: The factor, buys the receivables from the client, they become the factor's debts and the collection of cheques and other follow-up procedures are done by the factor in its own interest.

- **Provide Valuable advice**: The factors also provide valuable advice on country-wise and customer-wise risks. This is because the factor is in a position to know the companies of its country better than the exporter clients.

3.3.3 Types of factoring

1. Domestic factoring:

Factoring that arises from transactions relating to domestic sales is known as Domestic factoring. Domestic factoring may be of three types as described below.

a) Disclosed factoring:

In this type of factoring, the payment has to be made the buyer directly to the factor named in the invoice. The arrangement for factoring may take the form of recourse. Where by the supplier may continue to bear the risk of non-payment by the buyer without passing it on to the factor. In the case of nonrecourse factoring, factor assumes the risk of bad debt arising from non-payment.

b) Undisclosed factoring:

Under undisclosed factoring the name of the proposed factor finds no mention on the invoice made out by the seller of goods. At through the control of all monies remains with the factor the entire realization of the sales transaction is done in the name of the seller. This type of factoring is quite popular in the U.K.

c) Discount factoring:

Discount factoring is process where the factor discounts the invoices of the seller at a pre-agreed credit limit with the institutions providing finance, book debts and receivables serve as securities for obtaining financial accommodation.

2. Export factoring:

When the claims of an exporter are assigned to banker or any financial institution, and financial assistance is obtain on the strength of export documents and guaranteed payments it is called export factoring.

3. Cross – border factoring:

Cross border factoring involves the claims of an exporter which are assigned to a banker or any financial institution in the importer's country and financial assistance is obtained on the strength of the export documents and guaranteed payments.

4. Full – service factoring:

Full – service factoring also known as old – line factoring is a type of factoring where' by the factor has no recourse to the seller in the event of the failure of the buyers to make prompt payment of their dues to the factor, which might result from financial inability or insolvency of the buyer.

5. With Recourse factoring:

The factor has recourse to the client firm in the event of the book debts purchased becoming irrecoverable. The factor assumes no credit risks associated with the receivables. If the customer defaults in payment, the resulting bad debt loss shall be met by the firm.

6. Without Recourse factoring:

No right with the factor to have recourse to the client. The factor bears the loss arising out of irrecoverable receivables. The factor charges higher commission called "Delcredere commission" as a compensation for the said loss. The factor actively involves in the process of grant of credit and the extension of line of credit to the customers of the client.

7. Advanced and Maturity factoring:

The factor makes an advance payment in the range of 70 to 80 percent of the receivables factored and approved from the client the balance amount being payable after collecting from customers. The factor collects interest on the advance payment from the client.

8. Bank participation factoring:

It is variation of advance and maturity factoring under this system of factoring, the factor arranges a part of the advance to the clients through the banker. The net factor advance will be calculated as follows

[factor advance percent * Bank advance percent]

9. Collection / maturity factoring:

Under this type of factoring, the factor makes no advancement of finance to the client. The factor makes payment either on the guaranteed payment date or on the date of collection, the guaranteed payment date being fixed after taking into account the previous ledger experience of the client and the date of collection after the due date of the invoice.

3.3.4 Factoring procedure

The agreement between the supplier and the factor specifies the factoring procedure. Usually the firm sends the customer's order to the factor for evaluating the customer's creditworthiness and approval. Once the factor is satisfied about the customer's creditworthiness and agrees to buy receivables, the form dispatches goods to the customer.

The customer will be informed that his account has been sold to the factor, and he is instructed to make payment directly to the factor. to perform his functions of credit evaluation and collection for a large number of clients, a factor may maintain a credit department with specialized staff. Once the factor has purchased a firm's receivables and if he agrees to own them, he will have to provide protection against any bad-debt loses to the firm.

3.3.5 Advantages and disadvantages of factoring

The following are the advantages of factoring:

- ***Cost saving:*** Factoring allows for the elimination of trade discounts besides it also helps in reduction administrative cost and burden, facilitating cost and burden, facilitating cost savings. There is also over able savings in cost, expenses and efforts as there is no need for the client to maintain a special administrative setup to look after credit control.
- ***Leverage benefit:*** Another advantage of factoring is that it helps improved the scope of operating leverage.
- ***Enhanced return:*** Factoring is considered attractive to users as it helps enhance return.

- ***Liquidity:*** Factoring enhance liquidity of the firm by ensuring efficient working capital management. For instance it helps avoid increased debts in the case of without recourse factoring. Similarly, the efficient management of current assets leads to reduced working capital requirements, besides helping to minimize bad debt losses.
- ***Credit discipline:*** Factoring brings about better credit discipline amongst customers due to regular realization of dues. This is achieved through effective control of the sales journal, reduced credit risk, better working capital management, etc.
- ***Accelerated Cash flows:*** Accelerated cash flows help the client meet liabilities promptly, as and when they arise.
- ***Credit certificate:*** The factor's acceptance of the client's receivables is tart amount to credit certification by the factoring agency.
- ***Prompt payment:*** Factoring facilitates prompt payments and credits by providing insurance against bad debts.
- ***Information flow:*** Factoring ensures constant flow of critical information for the purpose of decision making and follow-up. It therefore helps eliminate delays and wastage of man-hours.
- ***Better linkages:*** Factoring allows for the promotion of linkages between bankers and factors. Such an arrangement help better dealings, debt protection, collection of sales ledger etc.,
- ***Infrastructure:*** Factoring acts as a stimulant to go in for sophisticated infrastructure to world's high level and specialization in credit control and sales ledger administration.
- ***Efficient production:*** The factor undertaking the responsibility of credit control sales ledger administration and debt collection problems. Thus the client can concentrate on functional areas of the business such as planning, purchase, production, marketing and finance.
- ***Reduced risk:*** Factoring allows for reduction in the uncertainty and risk associated with the collection cycle, since fund form a factor are an additional source of finance for the client outside the purview of MPBF.

- ***Export promotion:*** Factoring facilities are designed to help exporters avail of financial assistance on attractive terms, which in turn allows for promotion of exports.

Disadvantages of Factoring:

- Engaging a factor may be reflective of the inefficiency of the firms' receivables.
- Factoring may be redundant if a firm maintains a nation-wide network of branches
- Difficulties arising from the financial evaluation of client
- A competitive cost of factoring has to be determined before taking a decision about engaging a factor.

Check Your Progress

Learners in this section key concept of factoring are explained. Factoring is a financial service where businesses sell their accounts receivable to a third party (the factor) at a discount to improve cash flow and liquidity. This unit explores the mechanics of factoring, including the roles of the seller, factor, and debtor. Learners will learn about different types of factoring, such as domestic factoring, export factoring, cross – border factoring, full – service factoring, with recourse factoring and without recourse factoring. The unit also covers the potential disadvantages, including higher costs and dependency on the factor.

Let's Sum Up

1. **What is factoring?**

   A) A loan secured by accounts receivable

   B) Selling accounts receivable at a discount

   C) Issuing shares to the public

   D) Providing insurance against credit risk

2. **Which party in a factoring arrangement purchases the accounts receivable?**

A) Factor

B) Debtor

C) Seller

D) Creditor

3. **What is the main purpose of factoring for a business?**

A) Increase long-term investments

B) Improve short-term liquidity

C) Reduce tax liabilities

D) Expand product lines

4. **Which of the following best describes the mechanism of factoring?**

A) Selling future cash flows from receivables

B) Borrowing against inventory

C) Issuing bonds

D) Purchasing capital equipment on credit

5. **In recourse factoring, who bears the risk of non-payment by the debtor?**

- A) Factor
- B) Debtor
- **C) Seller**
- D) Insurer

3.4 Unit Summary

Learners in this unit we came to know about three vital financial services, namely Leasing, hire purchase and factoring. In the world of finance, these are pivotal instruments that businesses leverage to manage assets and cash flow. Leasing provides a way for firms to use assets without owning them, spreading the cost over a fixed term. Hire purchase,

on the other hand, allows companies to acquire assets through installment payments, ultimately leading to ownership once the final payment is made. Factoring offers a solution to improve cash flow by selling accounts receivables at a discount to a third party. Each method has unique benefits and considerations, essential for strategic financial planning.

3.5 Glossary

KEYWORDS	MEANING
Bailment	an act of delivering goods to a bailee for a particular purpose, without transfer of ownership.
Arbitration	a mechanism for resolving disputes between investors and brokers, or between brokers.
Stamp Duty	a tax imposed on the sale of property/property ownership by the state government. It is payable under Section 3 of the Indian Stamp Act, 1899.
Bad debts	loans or outstanding balances owed that are no longer deemed recoverable and must be written off.
Vendor	a party in the supply chain that makes goods and services available to companies or consumers.
Depreciation	*using debt (borrowed funds) to amplify returns from an investment or project.*
Leverage	*the ease with which a security or an asset can be converted into cashat market price.*
Liquidity	an act of delivering goods to a bailee for a particular purpose, without transfer of ownership.

3.6 Self-Assessment Questions

Short Answers: (5 Marks)

1. What do you mean by leasing? State the importance of leasing?

2. What are the characteristics of leasing?
3. List the advantages and disadvantages of leasing.
4. Define hire purchase. What are the rights of hirer?
5. What are the features of hire purchase?
6. List the advantages and disadvantages of hire purchase.
7. Define factoring. Enumerate the mechanism of factoring.
8. What are the functions of factoring?
9. List the advantages and disadvantages of factoring.

Long Answers: (8 Marks)

1. Briefly explain the types of lease.
2. Discuss regulatory framework for leasing in India.
3. State the differences between hire purchase and leasing.
4. Explain the types of factoring in detail.

3.7 Case Study

Leasing in Corporate Finance

Company Background

Tech Solutions Inc., a mid-sized IT services company, faced the challenge of upgrading its technology infrastructure to stay competitive. The company needed to acquire new servers, workstations, and networking equipment, which required significant capital investment.

Problem Statement

Tech Solutions Inc. had limited available capital and did not want to deplete its cash reserves or take on substantial debt. The goal was to

upgrade the technology infrastructure without impacting the company's liquidity and financial stability.

Decision to Lease

After evaluating various financing options, the management team decided to opt for an operating lease for the required technology equipment. This decision was based on several key factors:

1. *Cost Management*: Leasing allowed the company to spread the cost of the equipment over the lease term, which aligned with its budget constraints.
2. *Technological Upgrades*: Leasing provided the flexibility to upgrade equipment at the end of the lease term, ensuring that the company could keep pace with rapid technological advancements.
3. *Tax Benefits*: Lease payments were considered operational expenses, which provided tax advantages and improved the company's tax position.

Lease Agreement Details

Tech Solutions Inc. entered into a three-year operating lease agreement with a leading leasing company. The terms included:

- Monthly Lease Payments: $20,000
- Lease Term: 3 years
- *Option to Upgrade*: At the end of the lease term, with the possibility of entering a new lease agreement for upgraded equipment.
- *Maintenance and Support*: Provided by the leasing company, reducing the burden on Tech Solutions Inc.'s internal IT team.

Implementation and Outcomes

The leased equipment was installed within a month, significantly improving the company’s operational efficiency and service delivery. The key outcomes included:

1. *Enhanced Performance*: The new technology infrastructure boosted productivity and allowed the company to take on more complex projects, leading to a 15% increase in revenue within the first year.
2. *Cash Flow Management*: By leasing the equipment, Tech Solutions Inc. preserved its cash reserves for other strategic investments and working capital needs.
3. *Tax Savings*: The lease payments were fully deductible as operating expenses, resulting in annual tax savings of approximately $72,000.
4. *Flexibility*: The company retained the flexibility to upgrade its technology infrastructure every three years, ensuring that it remained at the forefront of technological advancements.

Question:

Illustrate how leasing proved to be an effective financial strategy for Tech Solutions Inc., to upgrade its technology infrastructure without significant upfront costs or financial strain

3.8 Answers for Check Your Progress

Modules	S.No.	Answers
Module 1	1.	B) Renting an asset
	2.	B) Temporary use of an asset
	3.	C) Flexibility in asset management
	4.	C) Flexibility in asset management
	5.	C) Complex regulatory requirements
Module 2	1.	B) Acquisition of goods through installment payments
	2.	B) To use the asset as per the agreement terms
	3.	B) Payment in installments with interest

	4.	B) Increased overall cost due to interest
	5.	A) Transfer of ownership upon final payment in hire purchase
Module 3	**1.**	B) Selling accounts receivable at a discount
	2.	A) Factor
	3.	B) Improve short-term liquidity
	4.	A) Selling future cash flows from receivables
	5.	C) Seller

3.9 Suggested Readings

- "*Financial Services*" by M.Y. Khan
- "*Leasing and Hire Purchase*" by R.M. Srivastava
- "*Financial Management: Theory and Practice*" by Prasanna Chandra
- "*Management of Banking and Financial Services*" by Padmalatha Suresh and Justin Paul

3.10 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Hire purchase	https://www.youtube.com/watch?v=fwMi9kQ-TNE
2.	Leasing	https://www.youtube.com/watch?v=1jh4gTe745g&t=9s https://www.youtube.com/watch?v=qZpWzkzdhQw https://www.youtube.com/watch?v=BOXqH3Lf_tU
3.	Factoring	https://www.youtube.com/watch?v=UwS-kPyVFwk https://www.youtube.com/watch?v=p0SvsfHTBXQ https://www.youtube.com/watch?v=yDJVb4DPQYw

3.11 References

- Financial Institutions and Markets – L M Bhole, The McGraw-Hill Companies.
- Banking & financial institutions - K.K.Jindal
- Financial Markets and Services – Gordon & Natarajan, Himalaya Publishing House.

UNIT 4 - VENTURE CAPITAL, CREDIT RATING, & CONSUMER FINANCE

Venture Capital – **Credit Rating** – Consumer Finance

Learners, in exploring the dynamics of venture capital, credit rating, and consumer finance, this unit aims to provide a comprehensive understanding of each domain's significance and interplay in the financial ecosystem. Venture capital fuels innovation by providing crucial funding and strategic support to emerging businesses. Credit rating offers a critical assessment of creditworthiness, influencing investment decisions and risk management. Consumer finance addresses the myriad financial products and services tailored to individual needs, enhancing personal financial management and access to credit. Through this unit, learners will gain insights into the mechanisms, benefits, and challenges associated with these pivotal financial instruments.

SECTION 4.1: VENTURE CAPITAL

In the 1920's and 1930's, the wealthy families of individual investors provided the start-up money for companies that would later become famous. Eastern Airlines and Xerox are the more famous ventures they financed. Among the early VC fund set-ups was the one by the Rockfeller family which started a special fund called Venrock in 1950, to finance new technology companies. General Georges Doriot (the father of venture capital), a professor at Harvard Business School, in 1946 set up the American Research and Development Corporation (ARD). ARD's approach was a classic VC in the sense that it used only equity, invested for long term. ARD's investment in Digital Equipment Corporation (DEC) in 1957 was a watershed in the history of VC financing. While in its early years VC may have been associated with high technology, over the years, the concept has undergone a change and, as it stands today, it implies pooled investment to unlisted companies.

4.1.1 Meaning of Venture Capital

The term venture capital comprises of two words, namely, ‘venture’ and ‘capital’. The term ‘venture’ literally means a ‘course’ or ‘proceeding’, the outcome of which is uncertain (i.e., involving risk). The term capital refers to the resources to start the enterprise. Thus, venture capital refers to *capital investment in a new and risky business enterprise*. Money is invested in such enterprises because these have high growth potential. A young hi-tech company that is in the early stage of financing and is not yet ready to make a public issue may seek venture capital. Such a high risk capital is provided by venture capital funds in the form of long term equity finance with the hope of earning a high rate of return primarily in the form of capital gain. In fact, the venture capitalist acts as a partner with the entrepreneur.

Venture capital is *the money and resources made available to start-up firms and small business with exceptional growth potential* (e.g., IT, infrastructure, real estate etc.). It is fundamentally a long term risk capital in the form of equity finance for the small new ventures which involve risk. But at the same time, it has the strong potential for the growth. It thrives on the concept of high risk high return. It is a means of equity financing for rapidly growing private companies.

Venture capital can be visualized as ‘your ideas and our money’ concept of developing business. It is ‘patient’ capital that seeks a return through long term capital gain rather than immediate and regular interest payments as in the case of debt financing. When venture capitalists invest in a business, they typically require a seat on the company’s board of directors. But professional venture capitalists act as mentors and provide support and advice on a number of issues relating to management, sales, technology etc. They assist the company to develop its full potential. They help the enterprise in the early stage until it reaches the stage of profitability. When the business starts making considerable profits and the market value of the shares go up to considerable extent, venture capitalists sell their equity holdings at a high value and thereby make capital gains.

In short, venture capital means the financial investment in a highly risk project with the objective of earning a high rate of return.

4.1.2 Characteristics of Venture Capital

The important characteristics of venture capital finance are outlined as bellow:

- It is basically equity finance.
- It is a long term investment in growth-oriented small or medium firms.
- Investment is made only in high risk projects with the objective of earning a high rate of return.
- In addition to providing capital, venture capital funds take an active interest in the management of the assisted firm. It is rightly said that, “venture capital combines the qualities of banker, stock market investor and entrepreneur in one”.
- The venture capital funds have a continuous involvement in business after making the investment.
- Once the venture has reached the full potential, the venture capitalist sells his holdings at a high premium. Thus his main objective of investment is not to earn profit but capital gain.

4.1.3 Types of Venture Capitalists

Generally, there are three types of venture capital funds. They are as follows:

1. **Venture capital funds set up by angel investors (angels)**: They are individuals who invest their personal capital in start-up companies. They are about 50 years old. They have high income and wealth. They are well educated. They have succeeded as entrepreneurs. They are interested in the start-up process.
2. **Venture capital subsidiaries of Corporations**: These are established by major corporations, commercial banks, holding companies and other financial institutions.

3. **Private capital firms/funds**: The primary source of venture capital is a venture capital firm. It takes high risks by investing in an early stage company with high growth potential.

4.1.4 Methods or Modes of Venture Financing / Dimensions of Venture Capital

Venture capital is typically available in four forms in India: equity, conditional loan, income note and conventional loan.

- **Equity**: All VCFs in India provide equity but generally their contribution does not exceed 49 percent of the total equity capital. Thus, the effective control and majority ownership of the firm remain with the entrepreneur. They buy shares of an enterprise with an intention to ultimately sell them off to make capital gains.
- **Conditional loan:** It is repayable in the form of a royalty after the venture is able to generate sales. No interest is paid on such loans. In India, VCFs charge royalty ranging between 2 and 15 per cent; actual rate depends on the other factors of the venture, such as gestation period, cost-flow patterns and riskiness.
- **Income note:** It is a hybrid security which combines the features of both conventional loan and conditional loan. The entrepreneur has to pay both interest and royalty on sales, but at substantially low rates.
- **Conventional loan**: Under this form of assistance, the enterprise is assisted by way of loans. On the loans, a lower fixed rate of interest is charged, till the unit becomes commercially operational. When the company starts earning profits, normal or higher rate of interest will be charged on the loan. The loan has to be repaid as per the terms of loan agreement.
- **Other financing methods:** A few venture capitalists, particularly in the private sector, have started introducing innovative financial securities like participating debentures introduced by TCFC.

4.1.5 Stages of Venture Capital Financing

Venture capital takes different forms at different stages of a project. The various stages in the venture capital financing are as follows:

1. **Early stage financing:** This stage has three levels of financing. These three levels are:
   (a) *Seed financing*: This is the finance provided at the project development stage. A small amount of capital is provided to the entrepreneurs for concept testing or translating an idea into business.
   (b) *Start up finance/first stage financing*: This is the stage of initiating commercial production and marketing. At this stage, the venture capitalist provides capital to manufacture a product.
   (c) *Second stage financing*: This is the stage where product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of business. Venture capital firms provide larger funds at this stage.
2. **Later stage financing**: This stage of financing is required for expansion of an enterprise that is already profitable but is in need of further financial support. This stage has the following levels:
   (a) *Third stage/development financing*: This refers to the financing of an enterprise which has overcome the highly risky stage and has recorded profits but cannot go for public issue. Hence it requires financial support. Funds are required for further expansion.
   (b) *Turnarounds*: This refers to finance to enable a company to resolve its financial difficulties. Venture capital is provided to a company at a time of severe financial problem for the purpose of turning the company around.
   (c) *Fourth stage financing/bridge financing*: This stage is the last stage of the venture capital financing process. The main goal of this stage is to achieve an exit vehicle for the investors and for the venture to go public. At this stage the venture achieves a certain amount of market share.
   (d) *Buy-outs*: This refers to the purchase of a company or the controlling interest of a company's share. Buy-out financing involves investments that might assist management or an outside party to acquire control of a company. This results in the creation of a separate business by separating it from their existing owners.

Advantages of Venture Capital

Venture capital has a number of advantages over other forms of finance. Some of them are:

- It is long term equity finance. Hence, it provides a solid capital base for future growth.
- The venture capitalist is a business partner. He shares the risks and returns.
- The venture capitalist is able to provide strategic operational and financial advice to the company.
- The venture capitalist has a network of contacts that can add value to the company. He can help the company in recruiting key personnel, providing contracts in international markets etc.
- Venture capital fund helps in the industrialization of the country.
- It helps in the technological development of the country.
- It generates employment.
- It helps in developing entrepreneurial skills.
- It promotes entrepreneurship and entrepreneurism in the country.

4.1.6 Venture Capital in India

In India, the venture capital plays a vital role in the development and growth of innovative entrepreneurships. Venture capital activity in the past was possibly done by the developmental financial institutions like IDBI, ICICI and state financial corporations. These institutions promoted entities in the private sector with debt as an instrument of funding. For a long time, funds raised from public were used as a source of venture capital. And with the minimum paid up capital requirements being raised for listing at the stock exchanges, it became difficult for smaller firms with viable projects to raise funds from the public.

In India, the need for venture capital was recognized in the 7th five-year plan and long term fiscal policy of the Government of India. In 1973, a committee on development of small and medium enterprises highlighted the need to foster VC as a source of funding new entrepreneurs and technology. VC financing really started in India in 1988

with the formation of Technology Development and Information Company of India Ltd. (TDICI) – promoted by ICICI and UTI.

The first private VC fund was sponsored by Credit Capital Finance Corporation (CEF) and promoted by Bank of India, Asian Development Bank and the Commonwealth Development Corporation, namely, Credit Capital Venture Fund. At the same time, Gujarat Venture Finance Ltd. and AFIDC Venture Capital Ltd. were started by state-level financial institutions. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net worth individuals.

4.1.7 Legal aspects of Venture Capital

The legal aspects relating to venture capital in India may be briefly explained as follows:

Regulatory Structure: The SEBI regulates venture capital industry in India. It announced the regulations for the venture capital funds in 1996, with the primary objective of protecting the interest of investors and providing enough flexibility to the fund managers to make suitable investment decisions. Venture capital funds appoint an asset management company to manage the portfolio of the fund. Any company proposing to undertake venture capital investments is required to obtain certificate of registration from SEBI. Venture capital fund can invest up to 40% of the paid up capital of the invested company or up to 20% of the corpus of the fund in one undertaking. At least 80% of funds raised by VCF shall be invested in equity shares or equity related securities issued by company whose shares are not listed on recognized stock exchange. Venture capital investments are required to be restricted to domestic companies engaged in business of software, information technology, biotechnology, agriculture, and allied sectors.

4.1.8 Guidelines for the Venture Capital Companies

The Government of India has issued the following guidelines for various venture capital funds operating in the country.

- The financial institutions, State Bank of India, scheduled banks, and foreign banks are eligible to establish venture capital companies or funds subject to the approval as may be required from the Reserve Bank of India.
- The venture capital funds have a minimum size of Rs.10 crores and a debt equity ratio of 1:1.5. If they desire to raise funds from the public, promoters will be required to contribute minimum of 40% of the capital.
- The guidelines also provide for NRI investment upto 74% on a non-repatriable basis.
- The venture capital funds should be independent of the parent organisation.
- The venture capital funds will be managed by professionals and can be set up as joint ventures even with non-institutional promoters.
- The venture capital funds will not be allowed to undertake activities such as trading, broking, and money market operations but they will be allowed to invest in leasing to the extent of 15% of the total funds deployed. The investment or revival of sick units will be treated as a part of venture capital activity.
- A person holding a position of being a full time chairman, chief executive or managing director of a company will not be allowed to hold the same position simultaneously in the venture capital fund/company.
- The venture capital assistance should be extended to the promoters who are now, and are professionally or technically qualified with inadequate resources.

Let's Sum Up

Learners this section holds about the topic venture capital which is a cornerstone of innovation, offering essential funding and strategic guidance to high-potential startups. By investing in early-stage companies, venture capitalists fuel growth, drive technological advancements, and foster entrepreneurial ecosystems. This dynamic form of financing not only supports the ambitious visions of entrepreneurs but also seeks

significant returns on investment through equity stakes. The symbiotic relationship between venture capitalists and startups propels industries forward, nurtures groundbreaking ideas, and ultimately contributes to economic development and job creation.

Check Your Progress

1. What is venture capital?

A. Debt financing for established businesses
B. Equity financing for startups and early-stage companies
C. Short-term loans for individuals
D. Government grants for small businesses

2. Angel investors are typically:

A. Large financial institutions
B. Wealthy individuals investing their own money
C. Government agencies
D. Mutual fund managers

3. Which stage of venture capital financing focuses on product development and market research?

A. Seed stage
B. Startup stage
C. Expansion stage
D. Mezzanine stage

4. Which regulatory body oversees venture capital activities in India?

A. Reserve Bank of India (RBI)
B. Securities and Exchange Board of India (SEBI)
C. Insurance Regulatory and Development Authority (IRDA)
D. Ministry of Finance

5. Which mode of venture financing involves providing funds in exchange for equity ownership?

A. Debt financing

B. Lease financing

C. Equity financing

D. Credit financing

SECTION 4.2: CREDIT RATING

Credit rating agencies in India do not have a distant past. They came into existence in the second half of the 1980s. As of now, there are six credit rating agencies registered under SEBI namely, CRISIL, ICRA, CARE, SMERA, Fitch India and Brickwork Ratings. Ratings provided by these agencies determine the nature and integrals of the loan. Higher the credit rating, lower is the rate of interest offered to the organization.

Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity. It is a rating given to a particular entity based on the credentials and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

Definition:

Moodys': "*Ratings are designed exclusively for the purpose of grading bonds according to their investment qualities*".

According to CRISIL, "Credit rating is an unbiased and independent opinion as to issuer's capacity to meet its financial obligations. It does not constitute a recommendation to buy/sell or hold a particular security".

"Credit rating is an unbiased and independent opinion as to issuer's capacity to meet its financial obligations. It does not constitute a recommendation to buyer/sell or hold a particular security".

4.2.1 Functions of Credit Rating

The credit rating firms are supposed to do the following functions,

1. Low-cost information

The credit rating agency collects, analyses, interprets and makes a proper conclusion of any complex data and transforms it into a very lucid and easily understandable manner.

2. Provides a basis for suitable risk and return

The instrument rated by rating agency gets greater confidence amongst investor community. It also gives an idea regarding the risk associated with the instrument.

3. Helps in formulation of Public policy

If debt instruments are professionally rated, it becomes very easy to judge the eligibility of various securities for inclusion in the institutional portfolio with greater confidence.

4. Provides superior information

Credit rating agency being an independent rating agency, due to highly trained and professional staffs and with the access to information which are not publicly available information, these agencies are able to deliver superior information.

5. Enhances corporate image

Better credit rating to any credit investment enhances visibility and corporate image in the industry.

4.2.2 Types of Credit Rating

1. Equity rating

The rating of equity issues in the capital market is called equity rating. At the same time if there is a decline in the dividend rate of an existing concern, compared to its previous years its previous years, its rating will get a beating.

2. Bond rating

Rating the bonds or debt securities issued by a company, governmental or quasi-governmental body is called bond rating. Bond is also issued in the domestic market by both state and central government.

3. Commercial paper rating

It is mandatory on the part of a corporate body to obtain the rating of approved credit rating agency to issue commercial paper. In India NBFCs like Sundaram Finance may issue the commercial papers which may be credit – rated by a credit rating agency.

4. Rating the borrowers

This includes rating a borrower to whom a loan or credit facility may be sanctioned.

5. Sovereign rating

This includes rating a country as to its credit worthiness, probability to risk etc.

4.2.3 Advantages and Disadvantages of Credit Rating

Advantages of credit rating:

The major advantage a good credit rating is that it eases financial transactions and keeps low-cost credit available. Some also claim that a high credit rating signals that a person is trustworthy and possesses good character. This is also a big help when searching for a job or obtaining security clearances for well-paying, high status work. With a sound credit background, you're also more likely to get loans and insurance at preferred rates with faster approval. A qualified consumer can also take advantage of the latest credit card offers that carry a low APR, discounts, gift certificates, airline miles and other rewards.

Credit rating serves following functions:

1) Provides superior Information:

Provides superior information on credit risk for three reasons: (i) An independent rating agency, unlike brokers, financial intermediates, underwriters who have vested interest in an issue, is likely to provide an unbiased opinion; (ii) Due to professional and highly trained staff, their ability to assess risk is better, and finally, (iii) the rating firm has access to a lot of information which may not be publically available.

2) Low cost information:

Rating firm gathers, analyses, interprets and summarizes complex information in a simple and readily understood formal manner. It is highly welcome by most investors

who find it prohibitively expensive and simply impossible to do such credit evaluation of their own.

3) Basis for a proper risk and return:

If an instrument is rated by a credit rating agency, then such instrument enjoys higher confidence from investors. Investors have some idea as to what is the risk associated with the instrument in which he/she is likely to take, if investment is done in that security.

4) Healthy discipline on corporate borrowers:

Higher credit rating to any credit investment tends to enhance the corporate image and visibility and hence it induces a healthy discipline on corporate.

5) Greater credence to financial and other representation:

When credit rating agency rates a security, its own reputation is at stake. So it seeks financial and other information, the quality of which is acceptable to it. As the issue complies with the demands of a credit rating agency on a continuing basis, its financial and other representations acquire greater credibility.

6) Formation of public policy:

Public policy guidelines on what kinds of securities are eligible for inclusions in different kinds of institutional portfolios can be developed with greater confidence if debt securities are rated professionally.

Disadvantages:

1. **Possibility of Bias Exist** :

The information collected by the rating agency may be subject to personal bias of the rating team. However, rating agencies try their best to provide an unbiased opinion of the credit quality of the company and/or instrument. If not, they will not be trusted.

2. **Improper Disclosure May Happen** :

The company being rated may not disclose certain material facts to the investigating team of the rating agency. This can affect the quality of credit rating.

3. **Impact of Changing Environment** :

Rating is done based on present and past data of the company. So, it will be difficult to predict the future financial position of the company. Many changes take place

due to changes in economic, political, social, technological, legal and other environments. All this will affect the working of the company being rated. Therefore, rating is not a guarantee for financial soundness of the company.

4. **Problems for New Companies** :

There may be problems for new companies to collect funds from the market. This is because; a new company may not be in a position to prove its financial soundness. Therefore, it may receive lower credit ratings. This will make it difficult to collect funds from the market.

5. **Downgrading by Rating Agency** :

The credit-rating agencies periodically review the ratings given to a particular instrument. If the performance of a company is not as expected, then the rating agency will downgrade the instrument. This will affect the image of the company.

6. **Difference in Rating** :

There are cases, where different ratings are provided by various rating agencies for the same instrument. These differences may be due to many reasons. This will create confusion in the minds of the investor.

4.2.4 Credit Rating Agencies in India

Credit Rating Information Services of India Limited (CRISIL)

CRISIL stands for Credit Rating Information Services of India Limited and it was the first credit rating agency set up in India in 1987. Today, CRISIL has become a global analytical company that rates companies, researches the markets and provides risk and policy advisory services to its clients. At the time of incorporation, the agency was promoted by ICICI Limited, UTI and many such financial institutions. The agency started operations in 1988.

CRISIL is headquartered in Mumbai. CRISIL provides independent opinion and efficient solutions by performing data analysis and research. It has a strong track record of growth and innovation. CRISIL has expanded its business operation to USA, UK, Poland, Argentina, Hong Kong, China and Singapore apart from India. The majority

shareholder of CRISIL is Standard & Poor's, one of the biggest credit rating agencies of the world.

CRISIL works with various governments and policy-makers in India and other developing nations to enhance and improve the infrastructure and meet the demands of the region. The agency has rated around 5180 SMEs in India and has issued in excess of 10,000 SME ratings overall. CRISIL commands revenue of Rs. 1,110 Crores with a net income of Rs. 298 Crores and an operating income of Rs. 320 Crores.

Credit Analysis and Research limited (CARE)

Credit Analysis and Research limited was established in 1993 and since then it has gone on to become India's second largest credit rating agency. It was promoted by Industrial Development Bank of India (IDBI), Unit Trust of India (UTI) Bank, Canara Bank and other financial institutions. CARE has its headquarters in Mumbai and regional offices in New Delhi, Bangalore, Chennai, Hyderabad, Ahmedabad and Kolkata. CARE has the primary function to perform rating of debt instruments, credit analysis rating, loan rating, corporate governance rating, claims-paying ability of insurance companies, etc. It also grades construction entities and courses undertaken by maritime training institutions. Ratings provided by CARE include financial institutions, state governments and municipal bodies, public utilities and special purpose vehicles.

The Information and Advisory Service Department of CARE prepares credit rating and reports on requests from business partners, banks and other financial entities. It also conducts sector-based studies and provides necessary advisories for valuation, financial restructuring and credit appraisal systems. CARE conducts an extensive research and rates SMEs based on their financial health. These ratings are provided under 8 levels where CARE SME 1 signifies excellent financial health with negligible risks and CARE SME 8 rank signifies lowest credit quality with highest credit risk.

Investment Information and Credit Rating Agency (ICRA)

Originally named as Investment Information and Credit Rating Agency, the organization was set up in 1991. It was a joint venture of Moody's and Indian financial

and banking service organizations. It was renamed to ICRA Limited and was listed in the Bombay Stock Exchange and National Stock Exchange in April 2007. ICRA, which is an independent professional corporate investment information and credit rating and advisory agency, is headquartered in Gurugram, Haryana.

ICRA assigns corporate governance rating, performance ratings, grading and provides ranking to mutual funds, hospitals and construction and real estate companies. The agency generates revenue of Rs 2.28 Billion. ICRA has a major focus on the MSME sector. To cater to its clients, the dedicated team of professionals has developed a linear scale for the concerned sector. It helps the agency to benchmark peers quite easily. ICRA ratings are used to analyze the credit risk in India.

Small and Medium Enterprises Rating Agency (SMERA)

Small and Medium Enterprises Rating Agency of India is one such agency that functions exclusively for the sector it was formed for, i.e. Micro, Small and Medium Enterprises. This agency was founded in 2005 by Small Industries Development Bank of India (SIDBI), Dun and Bradstreet Information Services India Private Limited (D&B) and various public, private sector and other MNC banks of India.

The agency has its headquarters in Mumbai. SMERA has been registered with SEBI as a credit rating agency and accredited by Reserve Bank of India in 2012. It is an external credit assessment institution (ECAI). SMERA rates bank loans under Base II guidelines. Grading of various instruments like IPO, bonds, commercial papers, NCDs, fixed deposits, security receipts, etc. is done by SMERA which can be used by all banks for capital adequacy requirements calculation as authorized by the RBI.

SMERA pioneered SME rating in India and till date it has rated more than 38,000 enterprises. Financial institutions highly consider SMERA ratings before approving or lending funds.

Onida Individual Credit Rating Agency of India (ONICRA)

ONICRA Credit Rating Agency is the private rating agency established by Sonu Mirchandani under ONIDA Finance. It is headquartered in Gurugram, Haryana.

The agency provides credit ratings, conducts risk assessment and provides analytical solutions to individuals, corporate and MSMEs.

The solutions offered by the agency helps organizations take informed decisions about lending funds to individuals, MSMEs and other organizations. After its establishment in 1993, the agency has gained expertise in assessing micro, small and medium enterprises.

It is one of the seven agencies licensed by the National Small Industries Corporation (NSIC) for the rating of SMEs. Onicra provides grading services as well. Its grading services include education grading, healthcare grading, solar energy grading and APMC grading.

Onicra has signed MoUs with 16 banks and NBFCs in India to provide interest rate concession to up to 1% to top MSME units. It performs a wide range of tasks such as accounting, finance, analytics, customer relations and back-end management. More than 2500 SMEs have been rated by Onicra in the past two and a half decades.

FITCH India

India Ratings and Research (Ind-Ra) is a credit rating agency that provides time-bound, accurate and prompt credit opinions. It is 100% owned subsidiary of the Fitch Group. Ind-Ra covers corporate issuers, financial institutions, banks, insurance companies, urban local bodies, structured finance and project finance. Fitch‘s Ind-Ra is headquartered in Mumbai and has branch offices in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad and Kolkata.

Ind-Ra is recognized by Securities and Exchange Board of India, National Housing Bank and the Reserve Bank of India. Fitch is a major financial information service provider and rating agency having its operations in more than 30 countries across the globe. It checks credit capacity of global leaders in all industries.

4.2.5 Credit Rating Companies in India with their Credit Rating Symbols

Debt category	Debt instrument	Rating symbols			Remarks
		CRISIL	ICRA	CARE	
Long term instrument	Debentures, bonds, preference shares	AAA	LAAA	CARE AAA	Highest safety
		*AA	*LAA	*CAREAA	High safety
		*A	*LA	*CAREA	Adequate safety
		*BBB	*LBBB	*CAREB	Moderate safety
		*BB	*LBB	*CAREBB	Inadequate safety
		*B	*LB	*CAREB	Risk prone
		*C	*LC	*CAREC	Substantial risk
		D	LD	CARED	Default
Medium term instruments	Fixed deposits	FAA A	MAAA	CARE AAA	Highest safety
		*FAA	*MAA	*CAREAA	High safety
		*FA	*MA	*CAREA	Adequate safety
		*FB	*MB	*CAREBBB	Inadequate safety
				*CAREBB	Inadequate safety
				*CAREB	Inadequate safety
		*FC	*MC	CAREC	Risk prone
		FD	MD	CARED	Default
Short term	Commercial	*P1	*A1	*PR-1	High safety

instrument	paper	*P2	*A2	*PR-2	Highest safety
		*P3	*A3	*PR-3	Adequate safety
		*P4	*A4	*PR-4	Risk prone
		*P5	*A5	*PR-5	Default

Check Your Progress

Learners this section encompasses about the subject matter credit rating which acts as a realm of financial services, credit rating is a pivotal metric that assesses the creditworthiness of borrowers, and be they individuals, corporations, or governments. Issued by agencies such as Moody's, S&P, and Fitch, these ratings reflect the likelihood of default and influence interest rates and investment strategies. By providing a standardized evaluation, credit ratings enhance market transparency and investor confidence, facilitating efficient capital allocation. They help investors gauge risk, guide lending decisions, and enable issuers to secure financing on favorable terms, thereby underpinning the stability and fluidity of financial markets.

Let's Sum Up

1. **What does a credit rating signify?**
   A. The overall profitability of a company
   B. The creditworthiness and default risk of a borrower
   C. The market share of a company
   D. The tax obligations of a corporation
2. **Credit ratings help in:**
   A. Tax planning for companies
   B. Assessing the risk of default for investors
   C. Increasing a company's product range
   D. Reducing market competition
3. **A sovereign credit rating evaluates:**
   A. The creditworthiness of individual investors

B. The financial stability of corporations
C. The credit risk of a country's government
D. The credit risk of municipal bonds

4. **One benefit of credit ratings to investors is:**
A. Reduced need for portfolio diversification
B. Simplified assessment of investment risk
C. Guaranteed investment returns
D. Elimination of market risks

5. **Which of the following is a major credit rating agency in India?**
A. Moody’s
B. Fitch Ratings
C. CRISIL
D. Standard & Poor’s

SECTION 4.3: CONSUMER FINANCE

When a bank or any other financial agency provides loan to a consumer for the purchase of consumer durable, it is called ‘Consumer finance’. A consumer may obtain loan for the purchase of a vehicle, refrigerator, washing machines, etc.

A consumer, with his limited income is not in a position to pay the full value of consumer durables but would like to take advantage of his future earnings and purchase them through instalment payment to his creditor. By doing so, he not only enjoys the product, but he is also in a position to repay the value of the product. During a period of inflation, when the money value is eroding, it is beneficial for the loan. The value of the durable goods will increase if he postpones his purchase. Hence, in consumer finance, banks provide loans to enable the consumer to purchase valuable goods.

4.3.1 Benefits to banks in consumer finance

Consumer finance enable banks to create money out of thin air. When a bank gives loan to a consumer, it sets off a chain of steps in the form of a procedure. They are-

- The customer is asked to produce a Performa invoice form the proposed seller of the goods.
- The consumer is asked to pay into the bank 15% of the value of the goods, he is proposing to buy.
- A pay order or draft is made by the bank in favour of the seller.
- The pay order or draft is given to the customer, who in turn delivers it to the seller.
- The goods are delivered and they are also insured.
- The customer starts paying the instalments from the subsequent month of his purchase.
- Before granting loan, a promissory note is obtained from the customer along with a guarantee.
- In case of default, the guarantor will be held liable.
- The interest will be on a declining balance by which the loan is made much cheaper, as the effective rate of interest will be less
- In the case of purchase of vehicles, the registration certificate book will contain hypothecation note because of which the sale of vehicles to any third party is prohibited.
- On the repayment of entire loan, the loan agreement is terminated, which was executed at the time of commencement of the loan.
- The promissory note is cancelled and returned to the customer.
- In the case of hypothecation of vehicles, a declaration will be given by the bank to the transport authorities for cancellation of hypothecation. The same will be done to insurance companies also.

4.3.2 Significance of consumer finance

We have already stated that the banker issues a cheque/pay order/draft in favour of the seller as a part of consumer loan.

The seller will either deposit in the same bank if he is a customer or in some other bank in which he has his account. In any case, there is no cash involved in the

entire transaction. The seller may also obtain loan from the bank for expanding his business. The cheque given by the customer may be appropriated towards the loan. Thus, the consumer loan is a kind of savings the banker is encouraging with the customer and it is capital mobilized in the economy which is a forced saving on the part of the customer as he has purchased the goods.

From the above transaction, we could conclude that a consumer loan granted by the bank.

- ✓ Benefits the consumer in the form of goods
- ✓ Benefit the seller in expanding his business
- ✓ Benefits the banker as he grants loan through book entries but in the process earns interest for the loan
- ✓ It benefits the producer with more demand for goods
- ✓ It creates more production, thereby more employment
- ✓ It increases the profit of the manufacturing company
- ✓ More dividend is declared and so the capital market expands

Thus, the consumer loan of the bank creates an all-round impact on the economy.

4.3.3 Different types of loans

Different types of loan are available for a consumer to avail from the bank. They are dealt below:

Loans can be classified as (a) *clean loan* (b) *secured loan.*

A. Clean loan

When a banker gives loan, not against any security but based on the anticipated income of the borrower, it is a clean loan. Example: when a salaried permanent employee of a government department is given loan for buying a vehicle, his monthly salary certificate is taken as a security and a statement from his employer that the loan amount will be deducted from his salary every month before disbursement is obtained.

The vehicle will also be hypothecated. However, for granting the loan, it is the salary of the employee that is taken as a proof but not as a security. Hence, it is a clean loan.

B. Secured loan

When loans are granted against the securities which are either purchased with the help of loan amount or which are used for obtaining additional funds, they are called secured loans. The security forms the major component in deciding the loan.

Banker will give secured loan in different forms. For an account holder, the banker will give secured loan as either (i) *overdraft* or (ii) *cash credit.*

***Overdraft**:* For overdraft, the account holder must have a current account and the borrower is given loan over and above his credit balance. In overdraft, the borrower has an advantage of getting lower interest for his loan. The interest rate is charged on the basis of the debit balance and according to the number of days the debit balance is prevailing in the account. Hence, the borrower under the overdraft facility will get cheap credit compared to others. But this loan is available only to selected customers.

Cash credit: Cash credit is different from overdraft. The borrower is given a stipulated sum for a stipulated period and it can be utilized by the borrower in any manner. For example, if Rs.10lakhs is given under cash credit from January to December, the borrower can utilize rs.2 lakhs in March, Rs.2 lakhs in June and the remaining balance of Rs.6 lakhs in November. The interest rate for this loan will be as given below: The first Rs.2 lakhs borrowed in March will be charged for 9 months, the loan taken in June will have interest 6 months and the last loan taken in November will carry interest for two months. Thus, the cash credit facility gives enough choice for the borrower to draw the money according to his requirements, at the same time; he has to pay lesser interest only. But if the borrower utilizes only part of the amount allocated, say, Rs.4lakhs against Rs.10lakhs allocated, the borrower will have to pay 'commitment charge' for the remaining unutilized portion. This kind of loan is more beneficial to such borrowers who require funds on a seasonal basis. Example: Industries purchasing raw material from the market at a particular season when the price will be lower.

Other types of secured loans

A banker may provide loans against securities in the following forms:

(a) Pledge

(b) Mortgage

(c) Hypothecation

(d) Assignment.

a) **Pledge**:- Pledge is applicable for movable goods and is governed by contract act. There is physical possession of security by the creditor, though ownership is still retained by the borrower. The banker exercises a lien on securities given to him and banker's lien is an implied pledge. A banker gives loan under pledge especially jewel loans.

b) **Mortgage:-** When loans are granted against immovable properties, it is mortgage. Here, the borrower who is the owner of the property surrenders his right of sale to the creditor or the mortgagee for obtaining loan. When the borrower defaults, the mortgagee will sell the property for recovering the loan. In some defaults, the mortgagee will sell the property for recovering the loan. In some cases, the mortgagee himself may take over the property as a settlement for the loan.

c) **Hypothecation:-** This is applicable to movable goods. The borrower is given loan for the purchase of goods or vehicles. Though the borrower is the owner of the security, the creditor has a charge on the security until the loan is repaid. If the borrower fails to pay, the creditor will cease the goods form the borrower. Thus, hypothecation provides a right for the creditor to take possession of the goods.

d) **Assignment:**- When there is a transfer of an actionable claim be a person to his creditor as a security, it is assignment. For example, a borrower has an insurance policy which is to mature in a couple of months. He may borrow firm a bank against the security of the insurance policy. The claim on the insurance policy is transferred by the borrower to the bank as a security for the loan. This is the transfer of an actionable claim. Similarly, book debts can be transferred to the banker for obtaining loan by a wholesaler. There are two types of assignment, namely, equitable assignment and legal assignment. Inequitable assignment, there is only a formal handing over of the policy by the borrower to the bank but

in legal assignment, the borrower will be transferring the policy in a legal manner towards the banker. The insurance company will also acknowledge the transfer.

Let's Sum Up

Learners this section holds about the topic consumer finance which is a cornerstone of financial services, providing individuals with access to credit and financial products tailored to their needs. This includes personal loans, credit cards, mortgages, and auto loans, enabling consumers to manage expenses, make significant purchases, and improve their quality of life. By offering flexible repayment options and competitive interest rates, consumer finance supports personal financial management and economic stability. It also fosters financial inclusion, empowering individuals to participate fully in the economy. Through responsible lending practices and financial literacy initiatives, consumer finance ensures sustainable growth and financial well-being for consumers.

Check Your Progress

1. Consumer finance primarily involves:

A. Financing for government projects

B. Loans and credit facilities for individuals

C. Funding for nonprofit organizations

D. Equity investments in startups

2. Consumer finance helps banks in:

A. Lowering operational costs

B. Meeting regulatory requirements

C. Attracting corporate clients

D. Generating interest income

3. A mortgage loan is primarily used for:

A. Financing education expenses

B. Purchasing real estate

C. Starting a new business

D. Investing in stocks

4. One benefit of consumer finance to individuals is:

A. Increased tax liabilities

B. Reduced access to credit

C. Improved purchasing power

D. Higher interest rates

5. **Consumer finance contributes to economic growth by:**

A. Encouraging personal savings

B. Limiting access to credit

C. Facilitating consumer spending

D. Decreasing consumer purchasing power

4.4 Unit Summary

Learners this section encompasses venture capital, credit rating, and consumer finance which forms an integral part of the financial services ecosystem. In financial services, venture capital fuels innovation by investing in promising start-ups, driving economic growth and technological advancement. Credit rating provides a critical assessment of creditworthiness, guiding investment decisions and ensuring market stability. Consumer finance empowers individuals through loans and credit, enhancing purchasing power and financial inclusion. Together, these elements form a dynamic ecosystem, supporting business growth, fostering trust in financial markets.

4.5 Glossary

KEYWORDS	MEANING
Risk Management	the process of identifying, assessing and controlling threats to an organization's capital, earnings and operations.
Commercial paper	an unsecured form of promissory note that pays a fixed rate of

	interest.
Credit Assessment	provides an indication of creditworthiness on an unrated entity or proposed financing structure.

4.6 Self-Assessment Questions

Short Answers: (5 Marks)

1. What do you mean by venture capital? What are the characteristics of venture capital?
2. Explain the types of venture capital.
3. Briefly explain the modes of venture financing.
4. Discuss the role of venture capital in the growth of innovative entrepreneurships.
5. Describe the legal aspects of venture capital.
6. Enumerate the guidelines for venture capital companies.
7. What is credit rating? Explain the functions of credit rating.
8. What are the types of credit rating? Explain.
9. List the advantages and disadvantages of credit rating.
10. What is consumer finance? State the importance of consumer finance.
11. List out the benefits to banks in consumer finance.

Long Answers: (8 Marks)

1. Discuss the various stages of venture capital financing.
2. Explain the various credit rating agencies in India.
3. Describe the various types of loan available for a consumer from the banks.

4.7 Case Study

A Real Life Example for Successful Venture Capital Funding

Venture capitalists are always on the lookout for the next big thing, and they are willing to take risks on companies that have the potential to bring in high returns. One such company is Snapchat, which was founded in 2011 by *Evan Spiegel* and *Bobby Murphy*. *The popular messaging app* allows users to send photos and videos that disappear after a certain amount of time.

In 2013, Snapchat raised $485 million from several venture capital firms, including *Kleiner Perkins Caufield* & Byers and *Benchmark Capital*. The funding valued the company at $3.5 billion. Since then, Snapchat has continued to grow in popularity, especially among young people. In 2017, the company was estimated to be worth $25 billion.

The success of Snapchat is due in part to the fact that it was able to tap into a demographic that other social media platforms were not reaching. Snapchats disappearing messages were appealing to young people who were concerned about privacy and wanted a platform that was less formal than Facebook.

The company has also been able to monetize its user base through advertising. In 2017, Snapchat generated $824 million in *advertising revenue*. This figure is expected to grow to $1.76 billion by 2019.

Snapchat is just one example of a company that has been able to find success with venture capital funding. In order to attract VC interest, startups need to have a strong business model and a team that is passionate about their product. They also need to be able to articulate their vision for the future and how they plan on achieving it.

Question:

Analyze and summarize the given case study.

4.8 Answers for Check Your Progress

Modules	S.No.	Answers
Module 1	1.	B. Equity financing for start-ups and early-stage companies
	2.	B. Wealthy individuals investing their own

		money
	3.	A. Seed stage
	4.	B. Securities and Exchange Board of India (SEBI)
	5.	C. Equity financing
Module 2	1.	B. Equity financing for start-ups and early-stage companies
	2.	B. Wealthy individuals investing their own money
	3.	C.Seed stage
	4.	B.Securities and Exchange Board of India (SEBI)
	5.	C.Equity financing
Module 3	1.	B.Loans and credit facilities for individuals
	2.	D. Generating interest income
	3.	B.Purchasing real estate
	4.	C.Improved purchasing power
	5.	C.Facilitating consumer spending

4.9 Suggested Readings

- "Venture Capital, Private Equity, and the Financing of Entrepreneurship" by Josh Lerner, Ann Leamon, and Felda Hardymon
- "Credit Risk Management for Indian Banks" by K. Vaidyanathan
- "Indian Financial System" by M. Y. Khan

4.10 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Venture capital	https://www.youtube.com/watch?v=a4aUX5u90oA https://www.youtube.com/watch?v=0lv_GyFYplI

2.	Credit rating	https://www.youtube.com/watch?v=j4ldlOcwRLc
3.	Consumer finance	https://www.youtube.com/watch?v=fGXa7sEXJlk

4.11 References

- Financial Institutions and Markets – L M Bhole, The McGraw-Hill Companies.
- Banking & financial institutions - K.K.Jindal
- Financial Markets and Services – Gordon & Natarajan, Himalaya Publishing House.

UNIT 5 - MUTUAL FUNDS & DIGITAL PAYMENTS

Mutual Funds: Meaning – Types – Functions –Advantages. Introduction to digital payments- crypto currency

SECTION 5.1: MUTUAL FUNDS

A mutual fund is a corporate body (trust) that attracts savings, which are then invested in money market, debt market and capital market instruments such as shares and debentures. A mutual fund acts as a link between the public and the capital market. It is promoted by an agreement between three entities, namely sponsor, trustee and Asset Liability Management Company (ALM.)

5.1.1 Organizational structure of Mutual Fund

The mutual fund is promoted by an agreement between three distinct group of people, via., Sponsor, Trustee ALM (Asset Liability Management Company)

Sponsor: They are like the promoters of a company and are responsible for starting the Mutual Fund. Mutual Fund such as LIC, TATAs, and BIRLAs are examples for Sponsor. They take the initiative of fulfilling all the initial measures required for promoting the Mutual Funds.

Trustee: These are the people who act as the watch dog for the properties of the mutual fund. Judges, Bankers and insurance companies are appointed as Trustees, who will look after the assets of the mutual Fund. Their main task is to supervise the assets of the mutual fund, so that on any account there should not be any erosion in the value of these assets.

ALM: The assets mobilized by the mutual fund are entrusted in the ALM company for investment in various companies. There will be diversified investments such as debt instruments (Bonds or Bills), Equities and foreign securities. As the ALM consists of experts in the field of investment portfolio the profitability of the investments is not only ensured, but it is also kept transparent through the declaration of NAV’s.

5.1.2 Types of Mutual Fund

From the point of investors:

1. ***Open-ended mutual fund***: Open- ended scheme consists of mutual funds which sell the units to the public. These mutual funds can also repurchase the units. There is no fixed maturity period. Initial Public Offer (IPO) is open for a period of 30 days and then reopens as an open –ended scheme after a period not exceeding 30 days from the date of closure of the IPO. Investors can buy or repurchase units at net asset value or net value related prices, as decided by the mutual fund.
2. ***Close-ended Mutual fund***: A close-ended mutual fund has its mutual fund open for a fixed period and whatever money invested forms the basis for investment in various securities. These mutual funds have fixed maturity period ranging from 2to 15 years. Once can invest in the scheme at the time of initial issue new units. The investors cannot buy units directly from the fund after the closing period. Example: UTI Master Share, 1986.
3. ***Growth-oriented Mutual Fund***: It has the object of capital appreciation through investment in equity shares. Normally, investment is done in equity shares of such companies which have high growth potential. Examples: Software companies, petrol chemical companies and MNCs will come under this category.
4. ***Income-oriented fund***: The main object of this type of fund is to provide regular income to the investor. So, the mutual fund would wish to invest the public money raised in bonds, debentures and other debt related instruments. In some cases, they may even invest inequity shares of companies with high dividend payout Example: UTI's Monthly income fund.
5. ***Specialized mutual fund***: When the mutual fund will be investing the investors' money in particular industry such as steel, or petroleum so that such industries will grow rapidly.
6. ***Domestic mutual fund***: When the mutual fund mobilizes savings from a particular geographic location like a country or region, it is known as domestic mutual fund. Example; UTI Mutual fund, LIC Mutual Fund and SBI Mutual Funds ,etc.

7. ***Off-shore mutual fund***: The object of launching off-shore mutual funds is to attract foreign capital for investment in the country of the issuing company. Due to these mutual funds, there is cross border fund flow. Off-shore mutual funds open up the capital market to the foreign investors and to global portfolio investments.

From the point of promoters:

1. ***Stock funds***: These are mutual funds which primarily invest in common stock, ranging from blue chip companies such as Hindustan Lever to newly promoted companies, They can be growth oriented funds or income oriented funds.
2. ***Bond funds***: These are mutual funds which invest in various types o bonds, for obtaining current income.
3. ***Balanced fund***: It is a combination of investment in company securities with government bonds. The purpose is to balance the commitment of the funds.
4. ***Index funds***: Here, the investment will be in those companies which form the part of index number of the stock exchange. For example, SENSEX refers to Sensitivity index number of Bombay Stock Exchange, consisting of 30 companies which influence the index of the stock exchange.
5. ***Money market funds***: Here, the mutual fund will be investing in short-term securities such as treasury bills, bank's Certificate of Deposits (CDs) and commercial paper. For example, promissory note of leading companies such as Sundaram Finance.
6. ***Dual fund***: The close-ended mutual fund units are traded in the open market and they have a specific duration. The fund sells two classes of stock-one is preferred shares and the other is income shares. Dividends on preferred shares are assured.
7. ***Leverage fund***: In this mutual fund, investments are made in common stock , whose value will appreciate. The mutual fund uses borrowed money in order to purchase shares and later on it is repaid form out of the sale of the units. The fund leverages on the interest rate, and pays form out of the dividends it earns on those shares.
8. ***Specialized funds***: These are funds set up for some specialized purpose.

(a) International funds: They consist of foreign securities

(b) Global funds: Here, the stocks are traded in market throughout the world with the exception of the country which launches the fund

(c) Regional or country funds: These may be confined to continents. In India, they are called off- shore funds.

(d) Sector funds: They are specializing in a particular industry and are regarded as aggressive funds. Example is India Development Bonds.

9. ***Taxation funds***: The investors in these funds will have exemption benefits from income tax. Example is Magmum of SBI Capital Market

10. ***Real Estate funds***: The mutual funds invest in real estate institutions such as commercial property company, residential builders and mortgage bankers. They are popular in U.S.A and U.K.

11. ***Junk-bond funds***: These funds are rated low and carry high risk. However, the reward comes in the form higher yields. They are not found in India. Junk-bond funds are popular in U.K.

5.1.3 Objectives of Mutual Fund

- To mobilize savings of people.
- To offer a convenient way for the small investors to enter the capital and the money market.
- To tap domestic savings and channelize them for profitable investment.
- To enable the investors to share the prosperity of the capital market.
- To act as agents for growth and stability of the capital market.
- To attract investments from the risk averse.
- To facilitate the orderly development of the capital market.

5.1.4 Benefits of Mutual Fund

❖ **From the point of view of banks**

1. It provides an opportunity to invest its funds in profitable stock
2. Banks can give loan on security of stock

3. Liquidity of stock is possible though stock exchange
4. Money market mutual fund provided short-term fund deployment.
5. Demand of stock by banks increase dynamism in capital market.
6. Higher interest rates can be offered for depositors by higher returns from mutual funds.

❖ **Form the point of view foreign investors:**

1. Mutual funds can attract foreign investment: Examples - Merry Lynch, Morgon Stanley.
2. Capital market gets additional funds by which it is made more dynamic.
3. Foreign exchange rate is maintained due to the inflow of foreign funds.
4. It strengthens the capital market and enables further growth.

❖ **From the point of view of Domestic investor**

1. It provides him regular income without much risk.
2. It ensures a higher return on his investment
3. It provides liquidity as he can encash the units any time
4. It ensures growth of his investment
5. Experts services are made available to the individual
6. It also provides tax shelter to the individual

❖ **From the point of view of Government**

1. It provides short-term funds to government as there are money market mutual funds.
2. Government promoter's investment trusts such as Unit Trust of India for attracting savings of middle and lower income group
3. Government can regulate capital market through the control of mutual funds.
4. It provides better opportunities for government to invest its funds in a profitable venture. Example: LIC mutual fund
5. Government can meet its revenue and capital expenditure with the income derived from mutual funds.

❖ **From the point of view of Economy**

1. Mutual funds ensure adequate funds to secondary sector

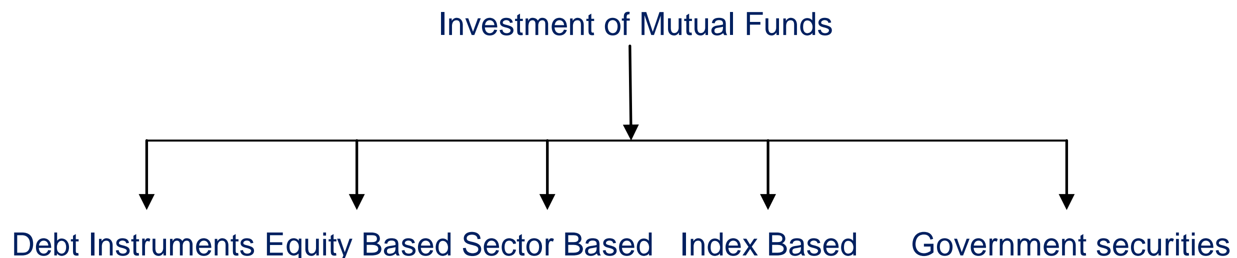
2. The return on mutual funds is an indication of the functioning of the economy
3. Small investors are mobilized and huge investments undertaken
4. Government sponsored mutual funds attract public funds which promote savings in the economy
5. Government ensures equal distribution of funds to various companies through its own mutual funds.

❖ **From the point of view of Capital market**

1. It attracts funds from the mutual funds
2. Huge volume of transaction are ensured
3. Wide fluctuations in the market prices are prevented by the presence of mutual funds
4. A fair return is given to the unit holders and it helps in bridging transparency to the capital market.

5.1.5 Investment of Mutual Fund

Mutual fund investments can be represented by the following diagram.



❖ ***Debt Instruments***: Mutual funds invest in debt instrument of companies, which carry attractive interest rates. By this, the mutual fund ensures a reasonable return for its investors. These will improve the Net Asset value of the Mutual fund. In fact, debt instruments are safe for investment, as they are backed by securities. For example, mortgage debentures of companies.

❖ ***Sector Investment***: Mutual Funds invest in different sectors of the economy. They may invest in fertilizer companies or pesticide companies in the primary sector. In the secondary sector, they may invest in power, iron & steel and cement industries by which infrastructure companies are promoted. In the

services sector, hotel industry and hospital along with banking and insurance companies 'shares are preferred.

- ***Equity based***: Investment are made by mutual funds in equity based companies, wherein the fundamentals of the company are good. If the company has good resources with a high earning per share, naturally such companies will be regarded more attractive for investment. There are fast moving consumer goods companies (FMCG) which have found more favour for investment.
- ***Index bond***: Index based investments are those which are called heavy weight age based companies. These companies have more volume and have higher value in the stock market. Such companies decide the Index of the market. There are also Sensex companies (sensitivity based) and Nifty companies. Thus, mutual funds will prefer such companies whose Index is high and which will decide the market conditions.
- ***Government Securities***: Initially, stock markets were dealing with both company securities and government securities. But after the stock scam (Harshad Metha), the Government has delinked the treasury securities form stock market. We have now a separate market for Government securities. This enables mutual funds to invest. There are also statutory obligations to invest in Government securities.

5.1.6 Regulations of SEBI of Mutual Fund

Regulation of SEBI of Mutual Funds

1. The mutual fund company must be a registered company
2. Before commencing mutual fund, prior permission of SEBI must be obtained.
3. Capital structure must be according to the regulation stipulated by SEBI

SEBI Control on Mutual Funds

Investment Expenditure On NAV On Transparency

4. Every mutual fund company must give their Net Asset Value periodically, (preferably weekly), in the leading newspapers of the country
5. Proper information about the mutual funds must be made though pamphlets, through websites and other methods so that the public is clear about their investment.
6. While investing funds, a mutual fund company cannot invest more than 10% of his investable funds in single company
7. Not more than 10% of the issued shares of the company can be purchase by mutual fund companies
8. Issuing of dividend, bonus shares, right shares etc., requires prior permission of SEBI
9. Any complaints about mutual funds can be made to SEBI directly and investigation on the working of a mutual fund will be conducted by SEBI.

5.1.7 Categories of Mutual Fund Schemes

1) By Structure

i) Open Ended Schemes: These schemes do not have a fixed maturity period. An open-ended fund sells and repurchases units at all times at a price linked to net asset value (NAV). These schemes are available for subscription and repurchase on a continuous basis. The key feature of these schemes is liquidity.

ii) Close Ended Schemes: A close-ended fund makes a one-time sale of a fixed number of units during the initial offer period. These schemes have a stipulated maturity period. The fund is open for subscription only during a specified period at a time of launch of the scheme. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

iii*) *Interval Schemes: These combine the features of open-ended schemes and close ended schemes which may be traded on the stock exchange any time or will be open for sale or redemption during predetermined intervals at NAV related prices.

2) Actively Managed Funds & Passive Funds

i) Actively Managed Funds: Funds where the fund manager has the flexibility to choose the investment portfolio, within the broad parameters of the investment objective of the scheme. Since this increases the role of the fund manager, the expenses for running the fund turn out to be higher. Investors expect actively managed funds to perform better than the market.

ii) Passive Funds: In this fund, investment on the basis of specified index, whose performance it seeks to track. The proportion of each share in the scheme's portfolio would also be the same as the weightage assigned to the share in the computation of the S & P BSE Sensex. The performance of these funds tends to the concerned index. It is not designed to perform better than the Index market. Such schemes are also called index schemes.

iii) Exchange Traded Funds: An ETF is an amalgam financial product, a cross between a stock and a mutual fund. ETF is a portfolio or basket of securities that replicate the composition of indices like NIFTY, BANKNIFTY, SENSEX etc. The units are issued to the investors in a New Fund Offer (NFO) after which they are available for sale and purchase on a stock exchange. The units of the ETF are traded at real time prices that are linked to the changes in the underlying index.

3) SEBI- Categorization & Rationalization of MF Schemes: The Schemes would be broadly classified in the following groups as per SEBI guidelines: Equity Schemes, Debt Schemes, Hybrid Schemes, Solution Oriented Schemes, and Other Schemes

4) Equity Schemes: An Equity scheme should invest minimum 65% of its assets in Equity and Equity related instruments.

- ***Large Cap Fund***: Investing in large cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be 80 percent of total assets.

- ***Mid Cap Fund***: Investing in mid cap stocks. The minimum investment in equity and equity related instruments of mid cap companies shall be 65 percent of total assets.
- ***Large and Mid Cap Fund***: Investing in both large and mid cap stock. Large Cap Stocks- Min 35 %, Mid Cap Stock- Min 35 % of total assets
- ***Multi Cap Fund***: Large Cap, Mid Cap and Small cap stocks. The minimum investment in equity and equity related instruments shall be 65 % of total assets.
- ***Equity Income or Dividend Yield Funds***: These funds mainly invest in stocks of companies whose dividend payout is higher. Capital appreciation is main object and increases the higher income through the dividends.
- ***Focused Fund***: Investing in maximum 30 stocks. The scheme document must mention the focus stock which may be Large Cap, Mid Cap, Small Cap, Multi Cap etc.
- ***Diversified Equity Fund***: These funds seek to invest substantially in equities, leaving a small portion in liquid money market securities. These funds seek to reduce the sector specific risks through diversification.
- ***Speciality Fund***: These funds invest in only predetermined portfolio of securities. Most of the speciality funds tend to be concentrated funds and are more volatile than diversified funds.
- ***Sector Funds***: The fund's portfolio consists of investment in only one industry or sector of the market such as pharmaceuticals, telecommunication, Financial Services and Banking, Information Technology etc. The returns in those funds are dependent on the performance of the respective sectors. These funds may give higher returns, but they are riskier compared to diversified funds.

5) Debt Schemes: Overnight Fund: The investment is in overnight securities having maturity of 1 day.

- ***Liquid Fund***: Investment is into money market and debt securities with maturity of up to 91 days
- ***Ultra Short Fund***: Investing in money market and debt instruments with maturity duration between 3 months and 6 months.

- ***Low Duration Fund***: Investing in debt and money market instruments with maturity duration between 6 months and 12 months.
- ***Money Market Fund***: Investing in money market instruments having maturity up to 1 year.
- ***Short Duration Fund***: Investing in debt and money market instruments with Macaulay duration between 1 year and 3 years.
- ***Medium Duration Fund***: Investing in debt and money market instruments with Macaulay duration of the portfolio being between 3 years and 4 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 4 years.
- ***Medium to Long Duration Fund***: Investing in debt and money market instruments with Macaulay duration between 4 years and 7 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 7 years.
- ***Long Duration Fund***: Investing in debt and money market instruments with Macaulay duration greater than 7 years.
- ***Dynamic Bond***: An open-ended dynamic debt scheme investing across duration.
- ***Corporate Bond Fund***: An open-ended debt scheme predominantly investing in AA+ and above rated corporate bonds. The minimum investment in corporate bonds shall be 80 percent of total assets (only in AA+ and above rated corporate bonds)

Hybrid Schemes:

- ***Aggressive Hybrid Fund/ Balanced Fund***: Investment in equity 65% to 80 % of total assets while investment in debt instruments shall be between 20 % and 35 % of total assets.
- ***Dynamic Asset Allocation or Balanced Advantage***: It is an open ended dynamic asset allocation fund with investment in equity/debt that is managed dynamically.
- ***Multi Asset Allocation***: An open-ended scheme investing in at least three asset classes with a minimum allocation of at least 10 percent each in all three asset

classes. Foreign securities are not treated as a separate asset class in this kind of scheme.

- ***Arbitrage Fund***: The minimum investment in equity and equity related instruments shall be 65 percent of total assets. They simultaneously buy and sell securities in different markets to take advantage of the price difference. Returns are more in line with money market returns, rather than equity market returns. Moderately Low Risk Category. Arbitrage funds are not meant for equity risk exposure, but to lock into a better risk-return relationship than liquid funds and ride on the tax benefits that equity schemes offer.

Solution Oriented Schemes

- ***Retirement Fund***: An open-ended retirement solution oriented• scheme having a lock-in of 5 years or till retirement age (whichever is earlier).
- ***Children's Fund***: An open ended fund for investment for children having a lock-in for at least 5 years or till the child attains age of majority (whichever is earlier).

Other Schemes

- ***Gold Exchange Traded Funds (GETFs):*** Gold Exchange Traded Funds offer investors an innovative, cost-efficient and secure way to access the gold market. Gold ETFs are intended to offer investors a means of participating in the gold bullion market by buying and selling units on the Stock Exchanges, without taking physical delivery of gold. GOLD ETF invests in 99.99% pure GOLD. NAV of GOLD ETF depends on Real Prices of GOLD Bullion. Gold funds invest in gold and gold-related securities.
- ***Real estate funds invest in real estate***: Commodity funds invest in asset classes like food crops, spices, fibers, industrial metals, energy products or precious metals as may be permitted by their investment charter. Direct investing in Commodities is not allowed in India
- ***Fund of Funds (FOFs)***: Fund of Funds is schemes that invest in other mutual fund schemes. Minimum investment in the underlying fund - 95% of total assets.

Criteria in Selection of Mutual Fund:

It is very important to carefully analyze a mutual fund before one chooses the right fund for himself. The following are a set of features to be looked into in a mutual fund.

- *Fund Manager's Track Record*: The fund manager should have a proven track record as efficient fund management is able to create confidence in the mind of the investor.
- *Portfolio Quality*: If the poor quality investments don't backfire, a fund might generate high returns. High credit ratings of investments, means that the fund is investing in low risk instruments, indicating portfolio safety.
- *Number of Retail Investors and Average Holding Size*: It is easier to deploy and manage a small fund but even if a few investors leave it, a small fund could be in trouble.
- *Size of fund*: Critical mass gives access to opportunities not available to smaller funds.
- *Weighted Average Maturity*: Longer maturities hedge against downward movement in interest rates while it could lose out on short term upswings in interest rates. Short maturities protect against rising interest rates.
- *Sudden change in Portfolio or NAV*: This might be a case of a revamp of the portfolio for good but also beware that it might suddenly be open to more risk due to a change in investment.
- *Dividend Frequency*: Tax free dividends are good for those looking for regular returns but frequent dividends can hinder capital growth through redeployment

5.1.8 Advantages of Mutual Fund

Mutual funds are growing all over the world. They are growing because of their importance to investors and their contributions in the economy of a country. The following are the advantages of mutual funds:

- **Mobilize small savings**: Mutual funds mobilize small savings from the investors by offering various schemes. These schemes meet the varied requirements of the people. The savings of the people are channelized for the development of the economy. In the absence of mutual funds, these savings would have remained idle.

- **Diversified investment**: Small investors cannot afford to purchase the shares of the highly established companies because of high market price. The mutual funds provide this opportunity to small investors. Even a very small investor can afford to invest in mutual funds. The investors can enjoy the wide portfolio of the investments held by the fund. It diversified its risks by investing in a variety of securities (equity shares, bonds etc.) The small and medium investors cannot do this.

- **Provide better returns**: Mutual funds can pool funds from a large number of investors. In this way huge funds can be mobilized. Because of the huge funds, the mutual funds are in a position to buy securities at cheaper rates and sell securities at higher prices. This is not possible for individual investors. In short, mutual funds are able to give good and regular returns to their investors.

- **Better liquidity**: At any time the units can be sold and converted into cash. Whenever investors require cash, they can avail loans facilities from the sponsoring banks against the unit certificates.

- **Low transaction costs**: The cost of purchase and sale of mutual fund units is relatively less. The brokerage fee or trading commission etc. are lower. This is due to the large volume of money being handled by mutual funds in the capital market.

- **Reduce risk**: There is only a minimum risk attached to the principal amount and return for the investments made in mutual funds. This is due to expert supervision, diversification and liquidity of units.

- **Professional management**: Mutual funds are managed by professionals. They are well trained. They have adequate experience in the field of investment. Thus investors get quality services from the mutual funds. An individual investor would never get such a service from the securities market.

- **Offer tax benefits**: Mutual funds offer tax benefits to investors. For instance, under section 80 L of the Income Tax Act, a sum of Rs. 10,000 received as dividend from a mutual fund (in case of UTI, it is Rs. 13,000) is deductible from the gross total income.

- **Support capital market**: The savings of the people are directed towards investments in capital markets through mutual funds. They also provide a valuable liquidity to the capital market. In this way, the mutual funds make the capital market active and stable.

- **Promote industrial development**: The economic development of any nation depends upon its industrial advancement and agricultural development. Industrial units raise funds from capital markets through the issue of shares and debentures. Mutual funds supply large funds to capital markets. Besides, they create demand for capital market instruments (share, debentures etc.). Thus mutual funds provide finance to industries and thereby contributing towards the economic development of a country.

- **Keep the money market active**: An individual investor cannot have any access to money market instruments. Mutual funds invest money on the money market instruments. In this way, they keep the money market active.

5.1.9 Problems of Mutual Fund in India

The following are some of the main problems that are being faced by Indian mutual funds.

1. Liquidity crisis.
2. Lack of innovation.
3. Inadequate research.
4. Conventional pattern of investment.
5. No provision for performance guarantee.
6. Inadequate disclosures.
7. Delays in service.

8. No rural sector investment base.
9. Poor risk management.

Let's Sum Up

Learners this section encompasses about the topic mutual fund which pool money from multiple investors to buy a diversified portfolio of stocks, bonds, or other securities. Managed by professional fund managers, they offer individual investors access to a broader range of investments than they could typically achieve on their own. Mutual funds provide the benefits of diversification, professional management, and liquidity, making them a popular choice for both new and seasoned investors. Mutual funds are accessible and liquid, but they come with management fees and varying performance.

Check Your Progress

1. Which of the following entities is responsible for managing the investment portfolio of a mutual fund?
   A. Sponsor
   B. Trustee
   C. Asset Management Company (AMC)
   D. Registrar and Transfer Agent
2. Which type of mutual fund scheme can be bought and sold on the stock exchange?
   A. Open-ended funds
   B. **Close-ended funds**
   C. Interval funds
   D. Balanced funds
3. What is one advantage of mutual funds in terms of liquidity?
   A. High minimum investment requirement
   B. **Easy to buy and sell units at NAV**
   C. Guaranteed returns
   D. High transaction costs
4. Which regulatory body oversees mutual funds in India?
   A. RBI

B. IRDAI

C. SEBI

D. Ministry of Finance

5. Which mutual fund category typically has the lowest risk?

A. Equity funds

B. Debt funds

C. Sector funds

D. Balanced funds

SECTION 5.2: INTRODUCTION TO DIGITAL PAYMENTS

Digital payment is referred to as those payments that take place using the various types of electronic medium. These methods do not require payment to be made in the form of cash or providing cheque. Digital payments are transactions that occur through digital or online modes. This means both the payer and the payee use electronic mediums to exchange money. The Government of India has taken several measures to promote and encourage digital payments. As part of the 'Digital India' campaign, the government aims to create a 'digitally empowered' economy that is 'faceless, paperless, and cashless'.

5.2.1 Modes of Digital Payments

1. Unified Payments Interface (UPI):

Unified Payments Interface (UPI) is a system that powers multiple bank accounts into a single mobile application, merging several banking features, seamless fund routing & merchant payments into one hood. It also caters to the "Peer to Peer" (P2P) collect request which can be scheduled and paid as per requirement and convenience.

2. Bharat Interface for Money (BHIM):

Bharat Interface for Money (BHIM) is a mobile app for easy and quick payment transactions using Unified Payments Interface (UPI). User can make instant bank-to-bank payments and pay and collect money using Mobile number, Bank a/c and IFSC code, Aadhaar number or Virtual Payment Address (VPA).

BHIM has the facility to scan & pay through QR code. User can check transaction history and can also raise complaint for the declined transactions by clicking on Report issue in transactions. BHIM is available in 20 regional languages (English, Hindi, Marathi, Tamil, Telugu, Malayalam, Oriya, Punjabi, Gujarati, Marwari, Haryanvi, Bhojpuri, Urdu, Konkani, Manipuri, Mizo, Khasi, Kannada, Bengali, Assamese) for better user experience. Users can also make transaction using from their feature phone as well by dialling *99#.

3. UPI 123PAY:

UPI 123PAY is an instant payment system for feature phone users who can use Unified Payments Interface (UPI) payment service in a safe and secure manner. Feature phone users will now be able to undertake a host of transactions based on four technology alternatives. They include calling an IVR (Interactive Voice Response) number, app functionality in feature phones, missed call-based approach and proximity sound-based payments.

4. UPI Lite:

"UPI LITE" offers a wallet in BHIM-UPI app for an amount of up to ₹2,000 on a smart phone, eliminating the need for the user to first obtain electronic authorization from his/her bank while making the payment, offering the user better experience in terms of improved speed and transaction success rate.

5. Cards (including RuPay Debit Cards)

Debit Cards, one of the many payment modes, are issued by banks that allow individuals to purchase items at physical stores through Point of Sale (POS) devices or e-commerce marketplaces. RuPay Debit Cards, developed by National Payments Corporation of India (NPCI) was launched by the Government of India to allow individuals to make payments digitally. To get a RuPay debit card, reach out to bank and ask them to issue one.

6. Immediate Payment Services (IMPS):

Immediate Payment Services (IMPS) is a real-time interbank electronic fund transfer service capable of processing person to person (P2P), person to account (P2A) and person to merchant (P2M) transactions. Individuals can make payments 24x7 using

their mobile number, Aadhaar number, bank account and IFSC code. Users can access IMPS through multiple channels such as mobile, internet, ATM and SMS.

7. Aadhaar Enabled Payment System (AePS):

Aadhaar Enabled Payment System (AePS) is a bank led model which allows online interoperable financial inclusion transaction at Point of sale (MicroATM) through the Business correspondent of any bank using the Aadhaar authentication. AePS allows you to do six types of transactions, the inputs required for a customer to do a transaction Bank Name, Aadhaar Number, Fingerprint captured during enrolment.

Banking Services Offered by AePS

- Cash Deposit
- Cash Withdrawal
- Balance Enquiry
- Mini Statement
- Aadhaar to Aadhaar Fund Transfer
- Authentication

8. BHIM Aadhaar Pay enables Merchants to receive digital payments from customers over the counter through Aadhaar Authentication. It allows for any Merchant associated with any acquiring bank live on BHIM Aadhaar Pay, to accept payment from customer of any bank by authenticating customer's biometrics.

9. Bharat Bill Payment System (BBPS):

Bharat Bill Payment System (BBPS) is a one-stop platform that provides an interoperable and easily accessible recurring and bill payment service to consumers via multiple channels like Internet Banking, Mobile Banking, Mobile Apps, UPI, etc. Users are able to bill payments across various categories including electricity, gas, water bills, telecom, DTH, etc.

10. National Electronic Toll Collection (NETC) FASTag

NETC FASTag provides an easy and convenient digital payment mechanism for toll payments. This is an interoperable solution available to individuals nationwide. With the use of Radio Frequency Identification (RFID) technology, the FASTag device allows for making toll payments directly while the individuals' vehicle is in motion.

11. e-RUPI

e-RUPI is a person and purpose specific, contactless and cashless digital payment solution. It can be issued as a prepaid QR code or SMS based electronic voucher which can be used by the Government / Private organizations for delivery of a specific subsidy or welfare benefit to the targeted citizens. The beneficiaries will be able to redeem e-RUPI voucher without a card, digital payments app or internet banking access, at the merchants accepting e-RUPI, simply by showing SMS or QR code. This contactless e-RUPI is easy, safe, and secure as it keeps the details of the beneficiaries completely confidential. The entire transaction process through this voucher is relatively faster and at the same time reliable, as the required amount is already stored in the voucher.

12. Unstructured Supplementary Service Data (USSD) / *99#:

*99# is a USSD based digital payment and banking service. Customers can avail this service by dialing *99#, a "Common number across all Telecom Service Providers (TSPs)" on their mobile phone and transact through an interactive menu displayed on the mobile screen. *99# service is currently offered by almost all leading banks & all GSM service providers and can be accessed in 13 different languages including Hindi & English.

Key services offered under *99# service includes:

- Interbank account to account fund transfer
- Balance enquiry
- Mini statement besides host of other services

5.2.2 Benefits and disadvantages of Digital Payments

Some of the key advantages of digital payment in India that have made them a preferred choice for transactions are:

1. **Faster Payments:** Digital payments allow immediate transactions that can be processed immediately, reducing the waiting time that one has to go through with traditional payment methods. This makes transactions seem smooth and efficient.
2. **Convenience in the Payment Procedure:** Digital payments enable swift and hassle-free transactions from your devices, eliminating the need for physical presence or documents.

Whether paying bills, shopping online, or transferring funds, digital payment methods offer a user-friendly experience that saves both time and effort.

3. **Better Payment Security:** Digital payment systems use encryption and system authentication protocols, which minimize the risk of unauthorized access and effectively prevent fraud. Our financial information is protected, keeping you stress-free throughout the entire process of making digital payments.
4. **Improved Efficiency:** Automation and digitization in payment processes have significantly enhanced operational efficiency. By minimizing manual intervention, errors are reduced, and financial workflows are streamlined, resulting in a more efficient and error-free system.
5. **Digital Record of Transactions:** Digital payments provide a traceable account of transactions, thereby guaranteeing safety. Such efficiency and credibility allow individuals and businesses to maintain accurate financial records. It is easy to monitor the payment history and can be referred to when required.
6. **Reduced Costs:** The digital payment framework eliminates the requirement of physical infrastructure, paperwork, and manual handling. This reduces the cost of transactions for business enterprises and financial institutions. Also, digital transactions usually include a lower cost of transfer as compared to traditional banking methods.
7. **Ease of Use:** The payment systems facilitate customer comfort. The old cash-processing machines that could only recognize clear notes and coins are being replaced by ATMs, which are accessible and easy to use. Digital payment systems are easy to operate and will not take additional effort to understand how they work.
8. **Low Fees:** Digital payment methods typically entail lower transaction fees compared to banking methods, contributing to overall cost efficiency.
9. **Boost Revenue:** Merchants can benefit from a wider consumer base and better cash flow by utilising digital payment methods, leading to higher revenue. Digital payments offer an efficient system, leading to higher customer satisfaction and smoother transactions, which can attract more customers in the future.
10. **Discounts and Savings:** Many online platforms provide discounts, cash back, or loyalty programmes. These discounts motivate the customers to go for the digital payment option, which saves them money and provides several benefits.
11. **Low Risk of Theft:** Digital payments diminish the possibility of the actual loss of money since it’s not physical. Transactions occur in the digital world, therefore rendering the

necessity of holding large amounts of currency physically unnecessary. This safeguards payments by preventing direct cash transactions and ensuring their protection.

12. **Customer Management:** Digital payment systems can frequently oversee and monitor the customers' transactions, preferences, and feedback, which gives the business more control over these aspects. This improves overall customer management by adjusting service offerings based on customer behaviour.
13. **Better Customer Experience:** The ease and convenience offered by digital payments enable customers to enjoy superior service, thereby enhancing their experience. Simplified payment processes result in increased customer satisfaction and a greater likelihood of future collaboration with the business.
14. **Efficient Record-Keeping Features:** Through the digital infrastructure, digital payments for offline businesses are recorded efficiently; thus, the business environment is friendlier than before. Today businesses and individuals can easily track, control, and analyze their financial activities to obtain financial transparency and improve the financial management process.

Disadvantages of digital Payments

1. **Technical problems:** Online payments are subject to technical failures or downtime, just like any other software that is dependent on technology. Though tech maintenance operations are announced in advance and usually take place during the night, sometimes, it can cause frustration among online shoppers. Especially when it takes place without prior warning, a lot of businesses experience heavy bounce rates.
2. **Password threats:** A registered user with a website who uses online payments pretty often, there are high chances that the online portal can have access to the personal information or bank account details. Though most transactions use OTPs (one-time passwords), the need for password protection arises in such situations. Especially dealing with different banks might face the risk of a privacy breach.
3. **Cost of fraud:** Just as more and more people are shifting to online payments and preferring them over other traditional forms of payment, so are cybercriminals. ID thefts, phishing attacks, and database exploits are becoming more common. In order to prevent these and increase security, businesses install a lot of payment-security softwares and eventually incur a lot of costs.
5. **Security Concerns:** Using online payments come with a lot of security risks. Without proper security measures, fraudsters can easily hack important financial information and

data. There are no verification systems like facial recognition or biometrics, criminals can easily get away without getting caught.

6. **Technological illiteracy:** One of the main disadvantages of online payments is the technological illiteracy among many people, especially the older generation. Since they don't have enough knowledge on how to go about using technology or smart phones, they refrain from using online payment methods. A lot of them also fear the complexities of it and continue to use traditional methods of payment. This is a huge drawback in developing countries like India.
7. **Limitations on amount and time:** Some banks limit the number of transactions in a day or the maximum amount to be transferred in a day. Most online transactions also have a time limit to complete the process (like receiving and accepting OTPs). All these limitations can prove to be pretty inconvenient to some users.
8. **Service fees and other additional costs:** While implementing online payment gateways, some services may demand setup costs or even processing fees for customers using those facilities. Setting up online payment options obviously requires access to the internet and other services that come along with it. This easily leads to incurring extra costs and both the sellers and customers can find it tiresome.
9. **Loss of smart cards:** Most online payments are done with the help of credit/debit cards, ATM cards, or identity cards. So if we lose any of these, automatically, your online payment accounts that are linked to our cards will be at risk too. Block your cards after informing the bank, but the time between losing card and blocking it may prove to be risky as many transactions by fraudsters can take place during that time period.
10. **False identity:** Unlike physical transactions, there are no ways to identify if the person making the online payment is the one he/she is claiming to be. Since there are no verification methods like photographs or signatures, most online payments are done behind a veil of anonymity. This can lead to a considerable amount of forgery and identity theft.

Let's Sum Up

Learners this section contains about digital payments which facilitates the electronic transfer of funds between parties, revolutionizing the way transactions are conducted. They encompass various methods such as credit/debit cards, mobile wallets, online banking, and cryptocurrencies.

Digital payments offer convenience, speed, and security, reducing the reliance on cash and enhancing financial inclusion. They play a crucial role in modern economies by enabling seamless transactions, supporting e-commerce growth, and fostering financial innovation. Understanding the mechanisms and benefits of digital payments is essential for navigating the evolving financial landscape.

Check Your Progress

1. **What is a digital payment?**
   A. Payment made using physical cash
   B. Electronic transfer of money between two parties
   C. Payment made through barter exchange
   D. Payment made using gold
2. **Which of the following is a common mode of digital payment?**
   A. Cash
   B. Cheque
   C. Mobile wallet
   D. Postal order
3. **What is a UPI (Unified Payments Interface)?**
   A. A type of credit card
   B. A digital payment system that allows money transfer between bank accounts
   C. An online banking service for international transfers
   D. A physical card used for shopping
4. **Which of the following is an example of an online payment gateway?**
   A. PayPal
   B. ATM
   C. Cash register
   D. Savings account
5. **What is a key security benefit of using digital payments?**
   A. Reduced need for internet
   B. Elimination of transaction fees

C. Encryption and secure authentication methods

D. Increased use of physical cash

SECTION 5.3: CRYPTOCURRENCY

Cryptocurrency, or digital currency, is used on the Internet and not connected to any centralized institution. Cryptocurrencies (or crypto) are digital financial instruments exchanged and recorded on public ledgers (known as blockchain) that do not require central intermediaries (e.g., commercial banks, central banks) for clearing and settlement. Users and transactions are public but pseudonymous, which means users' identities may be obscured. Initially introduced as payments tools, cryptocurrencies are mostly used as a form of investment. This in Focus introduces crypto market structure, regulatory frameworks, and policy issues.

- Individual coin ownership records are stored in a digital ledger that relies on strong cryptography to keep the ownership of coins from being counterfeited.
- Cryptocurrencies are still relatively new, and the market for these digital currencies is very volatile.
- Cryptocurrency doesn't exist in physical form (like paper money) and it is not typically issued by a central authority.
- Instead, it typically uses decentralized control as opposed to a central bank digital currency (CBDC).
- Since cryptocurrencies don't need banks or any other third party to regulate them; they tend to be uninsured and are hard to convert into a form of tangible currency.

5.3.1 Types of Cryptocurrency

The first kind of Cryptocurrency, Bitcoin, remains to this day the most used, valuable, and popular Cryptocurrency in the world. Along with Bitcoin, other alternative cryptocurrencies have been created with various degrees of functions and specifications. Some have been derivatives from Bitcoin, while others have been created from scratch.

- The bitcoin currency was started in 2009 by an anonymous figure or group, who went by the name of Satoshi Nakamoto.

- Altcoins are cryptocurrencies that were formed as a result of Bitcoin's popularity. Litecoin, Peercoin, Namecoin, Ethereum, Cardana, and Dogecoin are some of the more well-known cryptocurrencies.
- Etherium - This cryptocurrency network uses decentralized software and builds intelligent contracts on the network. This contract helps to avoid any type of fraud if tried by a third party. The token that is used to enable the transaction on this network is Ether.
- Dogecoin - This cryptocurrency is named after the image of the Shiba Inu dog on the coin. This became a popular meme that resulted in super high prices as later Tesla owner, Elon Musk backed it. It has no o upper limit on the no. of coins you want to mine.
- Cardano - It is a research-based approach conducted by a team of experts like engineers, mathematicians, or cryptographers. It is known as a more balanced and sustainable coin.
- Litecoin - Though it is similar to other coins, it is known for fast transaction time as it produces blocks at a quick rate. Charlie Lee created it in 2011 who was working as an engineer at Google.

5.3.2 Advantages and disadvantages of Cryptocurrency

The advantages of Cryptocurrency are:

- ✓ We can exchange money without a third party like credit or debit cards or banks
- ✓ It is cheaper than most other online transactions.
- ✓ It is safe and secure and offers an unprecedented level of anonymity.
- ✓ With modern Cryptocurrency systems, there is a wallet or account address accessible only by a public key and private key. The private key is only known to the owner of the wallet.
- ✓ Minimal processing fees are charged for funds transfers.

The disadvantages of Cryptocurrency are:

- ✓ The almost anonymous nature of Cryptocurrency transactions makes them ideal for carrying out illegal activities such as money laundering, tax evasion, and possibly even terrorism.

- ✓ Money transfers cannot be reversed.
- ✓ Cryptocurrencies are not accepted in all places and have a low worth outside of their limited use.
- ✓ It has been noted that Bitcoin is not rooted in any real-world commodities. However, some recent research suggests that the cost of producing a Bitcoin, which requires a larger and larger amount of energy, is directly linked to its price on the market.

5.3.3 Concerns over Cryptocurrency

As of March 2022, we had a total of 18500 cryptocurrencies across the world. All cryptocurrencies are not valuable.

- There are many digital currencies like Dogecoin, Shiba Inu coin, etc that were made just for fun. These currencies have no intrinsic value. However, because of the hype in the crypto market, they have gained a lot of popularity.
- Since most of the currencies are decentralized, they cannot be regulated and monitored. Cases have come up where millions of investors have been the victim of fraud.
- If complications arise with ownership and transactions of cryptocurrencies, investors can be in great threat as these currencies have no backing from central authorities.
- The Cryptocurrency and Regulation of Official Digital Currency Bill were introduced in the winter session of the Lok Sabha. This bill aims to facilitate the smooth working of cryptocurrencies in India and to provide it with a legal framework.
- According to this bill, a digital currency will be launched and regulated by the RBI. Another important decision that has been taken under this bill is the prohibition of private cryptocurrencies.
- According to the former governor of RBI, Raghuram Rajan, cryptocurrencies have no intrinsic value and are very volatile in nature. Many economists feel that cryptocurrencies can harm the financial stability of the country.

5.3.4 The legality of Cryptocurrency in India

In the present day, India does not outlaw or condone Cryptocurrency investments. In 2020, the Supreme Court of India lifted the ban on Cryptocurrency, which was enforced by the Reserve Bank of India. Since then, investing in Cryptocurrency is recognized as legitimate though the extent and details of how taxes will be paid and how it will be regulated are still unclear.

Status of Cryptocurrency in India

In recent times, numerous efforts have been taken by the Government of India to legalize cryptocurrencies.

- A flat tax rate of 30% has been announced for any income from the transfer of these digital assets.
- All the holders of cryptocurrencies will have to disclose the number of holdings and the details of their deposits.
- The RBI will also launch its digital currency in the coming days. The steps were taken by the Government of India clearly indicate that they have permitted investing and trading of cryptocurrencies in India.

5.3.5 Future of Cryptocurrency in India

In the Union Budget 2022- 23, the finance minister of India made two important announcements related to Cryptocurrencies. The government of India plans to Levy a 30% tax on the profit earned through crypto-assets. And in the fiscal year 2022-23, 'Digital Rupee' will be introduced. From tier 2 and tier 3 cities, millennial are trying to familiarize themselves with Cryptocurrency. And recently a survey gives the report of increasing women's participation (grown over 1000%) in the field of Cryptocurrency. And there are 66% of people who invest in Cryptocurrency are below the age of 35 years.

Thus, the youth of the country is actively participating in the slowly growing era of Cryptocurrency. By the tech-savvy generation, P2P platforms are known to contribute to the substantial adoption of Cryptocurrency. The increasing mainstream acceptance of

Cryptocurrency may also influence the other segments of the population. And such changes can contribute to making the economy of the country grow exponentially.

Let's Sum Up

Learners this section contains a broad coverage about the topic Cryptocurrency. It is a digital or virtual form of currency that uses cryptography for secure financial transactions. Operating on decentralized networks based on blockchain technology, cryptocurrencies offer a transparent, immutable ledger for recording transactions. They provide advantages such as enhanced security, lower transaction fees, and global accessibility. However, they also come with challenges like price volatility, regulatory uncertainty, and potential misuse. Understanding cryptocurrencies involves exploring their technological foundations, economic implications, and the evolving regulatory landscape.

Check Your Progress

1. What is a Cryptocurrency?

A. A physical form of currency issued by a central bank
B. A digital or virtual currency that uses cryptography for security
C. A traditional banking instrument
D. A type of credit card

2. Which Cryptocurrency is often referred to as "digital gold"?

A. Bitcoin
B. Ethereum
C. Ripple
D. Litecoin

3. One advantage of using Cryptocurrency is:

A. High transaction fees
B. Slow transaction speeds
C. Decentralization and reduced control by central authorities

D. Inability to use internationally

4. Which organization in India has provided guidelines and regulations related to Cryptocurrency?

A. SEBI (Securities and Exchange Board of India)

B. IRDAI (Insurance Regulatory and Development Authority of India)

C. RBI (Reserve Bank of India)

D. TRAI (Telecom Regulatory Authority of India)

5. One disadvantage of Cryptocurrency is:

A. Stability in value

B. Lack of security

C. Price volatility

D. High trust in traditional banking

4.4 Unit Summary

In the realm of financial services, mutual funds, digital payments, and cryptocurrencies each play pivotal roles in modernizing and diversifying financial interactions. Mutual funds pool resources from multiple investors to create diversified portfolios managed by professionals, offering access to a range of assets and the benefits of diversification and expert oversight. Digital payments transform transactional landscapes by enabling fast, secure, and convenient electronic money transfers, promoting financial inclusion and reducing reliance on cash. Cryptocurrencies, leveraging blockchain technology, introduce decentralized digital currencies that enhance security and offer global accessibility, though they come with challenges like volatility and regulatory scrutiny. Together, these elements represent the evolving facets of financial services, driving innovation and expanding opportunities for investors and consumers alike.

4.5 Glossary

KEYWORDS	MEANING
Net Asset Value (NAV)	It is the value of an investment fund that is determined by subtracting its liabilities from its assets. The fund's per-share NAV

	is then obtained by dividing NAV by the number of shares outstanding.
Debentures	A debenture is a type of long-term debt instrument that is not backed by collateral.
Dividends	In Mutual Fund schemes, dividends are distributed when the fund has booked profits on the sale of securities in its portfolio.
Sensex	SENSEX stands for Stock Exchange Sensitive Index. The Sensex is the benchmark index of the BSE in India. The Sensex comprises 30 of the largest and most actively traded stocks on the BSE and provides a gauge of India's economy.
Nifty	NIFTY, short for National Stock Exchange Fifty, is an index representing top 50 companies listed on India's NSE.
New Fund Offer (NFO)	A New Fund Offer (NFO) is the first subscription offering for any new fund offered by an investment company.

4.6 Self-Assessment Questions

Short Answers: (5 Marks)

1. Briefly explain the organizational structure of mutual fund.
2. What are the objectives of mutual fund?
3. List out the benefits of mutual fund.
4. Briefly elaborate investment of mutual fund.
5. Explain the regulations of SEBI of mutual fund.
6. What are the advantages and drawbacks of mutual fund?
7. What are the benefits and disadvantages of digital payment?
8. What is Cryptocurrency? List the various types of Cryptocurrency?
9. What are the benefits and disadvantages of Cryptocurrency?

Long Answers: (8 Marks)

1. Elucidate the types of Mutual fund.
2. Categorize and explain the schemes of mutual fund.

3. What is digital payment? Explain the various modes of digital payments.
4. Elucidate the legal aspects and future of Cryptocurrency in India.

4.7 Case Study

Investing in Mutual Funds

Background:

John, a 35-year-old marketing professional, has recently received a bonus of $10,000 from his employer. He wants to invest this money to grow his wealth over the long term. John has heard about mutual funds but is not entirely sure how they work or which type of mutual fund would be best for his investment goals. He approaches a financial advisor to understand more about mutual funds and how he can make a smart investment decision.

Financial Advisor's Analysis:

1. Understanding John's Financial Goals:
    - John wants to invest his bonus for at least 10 years.
    - He seeks a balance between growth and risk.
    - He is open to moderate risk for potentially higher returns.

2. **Explaining Mutual Funds:**
    - Mutual Fund Structure: The advisor explains that mutual funds pool money from multiple investors to invest in a diversified portfolio of stocks, bonds, or other securities, managed by professional fund managers.
    - Types of Mutual Funds: Various types include equity funds, debt funds, balanced funds, index funds, sector funds, and money market funds.

3. **Recommending Suitable Mutual Funds:**
    - Equity Funds: These invest primarily in stocks and have the potential for high returns, but come with higher risk.
    - Balanced Funds: These invest in a mix of equities and fixed income securities, offering moderate growth with lower risk compared to pure equity funds.

- Index Funds: These aim to replicate the performance of a specific index like the S&P 500, offering diversification with lower management fees.

4. **Discussing the Benefits and Risks:**
   - Benefits: Diversification, professional management, liquidity, and potential for high returns.
   - Risks: Market risk, management risk, and interest rate risk for bond funds.

5. **Regulatory Framework:**
   - Mutual funds are regulated by the Securities and Exchange Commission (SEC) in the U.S., ensuring transparency and protecting investors' interests.

6. **Advisor's Recommendation:**
   - Given John's moderate risk appetite and long-term investment horizon, the advisor recommends a balanced fund to achieve a good mix of growth and stability.

Questions:

1. What are the key factors that John should consider when choosing a mutual fund for his investment?
2. Explain the different types of mutual funds that the financial advisor introduced to John.
3. What are the main benefits of investing in mutual funds for an individual like John?
4. What are the potential risks associated with mutual fund investments?
5. If John were more risk-averse, what type of mutual fund might the advisor have recommended instead?

4.8 Answers for Check Your Progress

Modules	S.No.	Answers
Module 1	1.	C. Asset Management Company (AMC)
	2.	B.Close-ended funds
	3.	B.Easy to buy and sell units at NAV

	4.	C.SEBI
	5.	B.Debt funds
Module 2	1.	B. Electronic transfer of money between two parties
	2.	C. Mobile wallet
	3.	B. A digital payment system that allows money transfer between bank accounts
	4.	A. PayPal
	5.	C. Encryption and secure authentication methods
Module 3	1.	D. A digital or virtual currency that uses cryptography for security
	2.	A. Bitcoin
	3.	E. Decentralization and reduced control by central authorities
	4.	C. RBI (Reserve Bank of India)
	5.	C. Price volatility

4.9 Suggested Readings

- "Cashless India: Digital Payments Revolution" by V. Pattabhi Ram and K. Raghu
- "Digital Payments in India: Challenges and Prospects" by Prof. Dhanya Pramod
- "Bitcoin and Cryptocurrency Technologies: A Comprehensive Introduction" by Arvind Narayanan et al.
- "Digital Payments in India" by Dr. Vidya S.

4.10 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Mutual Fund	https://www.youtube.com/watch?v=PbldLCsspgE

2.	Cryptocurrency	https://www.youtube.com/watch?v=dgjZ2fHg4y4

4.11 References

- "Mutual Funds in India: Structure, Performance and Future Prospects" by Amitabh Gupta
- Financial Institutions and Markets – L M Bhole, The McGraw-Hill Companies.
- "Digital Payment Ecosystem: Evolution, Emerging Trends and Future of the Global Payments" by Sahil Nanda