Indian Financial System

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INTRODUCTION

The capital market encourages economic growth. The various institutions which operate in the capital market give quantities and qualitative direction to the flow of funds and bring rational allocation of resources. A well-developed capital market comprising expert banking and non-banking intermediaries brings stability to the value of stocks and securities.

A financial system is a composition of various institutions, markets, regulations and laws, practices, money managers, analysts, transactions, and liabilities. This book thoroughly describes the Indian Five parts consist of: Financial System, The Indian Financial System is organized in five parts, consist of: The Indian Financial System, Indian Money Market, Indian Capital Market, and Fee-Based Financial Services.

In addition, important topic and depth discussion of the Indian Financial System includes the following:

- Constituents of financial system
- Functions of the Indian financial system
- Role of the money market in economy
- Producing information and allocating capital
- Capital market in India

This book offers a comprehensive and well-crafted topic the Indian Financial System. This book is also suitable for readers interested in learning about money, banking, and the financial system in the context of contemporary events, policy, and business. Researcher and students can selectively read this book for their references and studies.

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CH. 1

FINANCIAL SYSTEM

An Overview of Indian Financial System

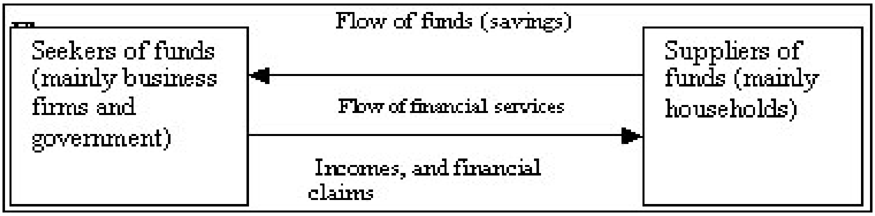
Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. We discuss the meaning of finance and Indian Financial System and focus on the financial markets, financial intermediaries and financial instruments. The brief review on various money market instruments

1.1 INDIAN FINANCIAL SYSTEM

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.

There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities.

Financial System;



The word "system", in the term "financial system", implies a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy.

The financial system is concerned about money, credit and finance- the three terms are intimately related yet are somewhat different from each other. Indian financial system consists of financial market, financial instruments and financial intermediation. These are briefly discussed below;

1.2 FINANCIAL MARKETS

A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial Assets or Financial Instruments represents a claim to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend.

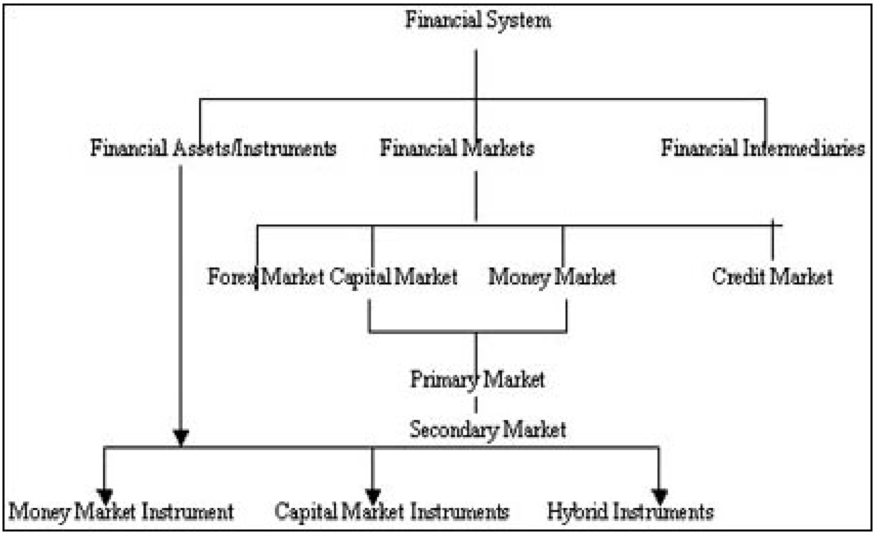
Money Market- The money market ifs a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

Capital Market- The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.

Forex Market- The Forex market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

Credit Market- Credit market is a place where banks, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.

Constituents of a Financial System



1.3 FINANCIAL INTERMEDIATION

Having designed the instrument, the issuer should then ensure that these financial assets reach the ultimate investor in order to garner the requisite amount. When the borrower of funds approaches the financial market to raise funds, mere issue of securities will not suffice. Adequate information of the issue, issuer and the security should be passed on to take place. There should be a proper channel within the financial system to ensure such transfer. To serve this purpose,

Financial intermediaries came into existence. Financial intermediation in the organized sector is conducted by a wide range of institutions functioning under the overall surveillance of the Reserve Bank of India. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating in the financial markets include; investment bankers, underwriters, stock exchanges, registrars, depositories, custodians, portfolio managers, mutual funds, financial advertisers financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc. Though the markets are different, there may be a few intermediaries offering their services in more than one market e.g. underwriter. However, the services offered by them vary from one market to another.

Intermediary	Market	Role
Stock Exchange	Capital Market	Secondary Market to securities
Investment Bankers	Capital Market, Credit Market	Corporate advisory services, Issue of securities
Underwriters	Capital Market, Money Market	Subscribe to unsubscribed portion of securities
Registrars, Depositories, Custodians	Capital Market	Issue securities to the investors on behalf of the company and handle share transfer activity
Primary Dealers Satellite Dealers	Money Market	Market making in government securities
Forex Dealers	Forex Market	Ensure exchange ink currencies

1.4 FINANCIAL INSTRUMENTS

A. Money Market Instruments

The money market can be defined as a market for short-term money and financial assets that are near substitutes for money. The term short-term means generally a period upto one year and near substitutes to money is used to denote any financial asset which can be quickly converted into money with minimum transaction cost.

Some of the important money market instruments are briefly discussed below;

1. Call/Notice Money
2. Treasury Bills
3. Term Money
4. Certificate of Deposit
5. Commercial Papers

1. **Call/Notice-Money Market:** Call/Notice money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call (Overnight) Money. Intervening holidays and/or Sunday are excluded for this purpose. Thus money, borrowed on a day and repaid on the next working day, (irrespective of the number of intervening holidays) is "Call Money". When money is borrowed or lent for more than a day and up to 14 days, it is "Notice Money". No collateral security is required to cover these transactions.

2. **Inter-Bank Term Money:** Inter-bank market for deposits of maturity beyond 14 days is referred to as the term money market. The entry restrictions are the same as those for Call/ Notice Money except that, as per existing regulations, the specified entities are not allowed to lend beyond 14 days.

3. **Treasury Bills.:** Treasury Bills are short term (up to one year) borrowing instruments of the union government. It is an IOU of the Government. It is a promise by the Government to pay a stated sum after expiry of the stated period from the date of issue (14/91/182/364 days i.e. less than one year). They are issued at a discount to the face value, and on maturity the face value is paid to the holder. The rate of discount and the corresponding issue price are determined at each auction.

4. **Certificate of Deposits:** Certificates of Deposit (CDs) is a negotiable money market instrument nod issued in dematerialized form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI. Banks have the freedom to issue CDs depending on their requirements. An FI may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and interoperate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

5. **Commercial Paper:** CP is a note in evidence of the debt obligation of the issuer. On issuing commercial paper the debt obligation is transformed into an instrument. CP is thus an unsecured promissory note privately placed with investors at a discount rate to face value determined by market forces. CP is freely negotiable by endorsement and delivery. A company shall be eligible to issue CP provided- (a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore; (b) the working capital (fund-based) limit of the company from the banking system is not less than Rs.4 crore and (c) the borrowal account of the company is classified as a Standard Asset by the financing bank/s. The minimum maturity period of CP is 7 days. The minimum credit rating shall be P-2 of CRISIL or

such equivalent rating by other agencies. (for more details visit www.indianmba.com faculty column)

B. Capital Market Instruments

The capital market generally consists of the following long term period i.e., more than one year period, financial instruments; In the equity segment Equity shares, preference shares, convertible preference shares, non-convertible preference shares etc and in the debt segment debentures, zero coupon bonds, deep discount bonds etc.

C. Hybrid Instruments

Hybrid instruments have both the features of equity and debenture. This kind of instruments is called as hybrid instruments. Examples are convertible debentures, warrants etc.

Money Market Concept, Meaning

There are two types of financial markets viz., the money market and the capital market. The money market in that part of a financial market which deals in the borrowing and lending of short term loans generally for a period of less than or equal to 365 days. It is a mechanism to clear short term monetary transactions in an economy.

Definitions of Money Market

Following definitions will help us to understand the concept of money market.

According to **Crowther**, "The money market is a name given to the various firms and institutions that deal in the various grades of near money."

According to the **RBI**, "The money market is the centre for dealing mainly of short character, in monetary assets; it meets the short term requirements of borrowers and provides liquidity or cash to the lenders. It is a place where short term surplus investible funds at the disposal of financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government."

According to **Nadler and Shipman**, "A money market is a mechanical device through which short term funds are loaned and borrowed through which a large part of the financial transactions of a particular country or world are degraded. A money market is distinct from but supplementary to the commercial banking system."

These definitions help us to identify the basic characteristics of a money market. A money market comprises of a well organized banking system. Various financial instruments are used for transactions in a money market. There is perfect mobility of funds in a money market. The transactions in a money market are of short term nature.

Functions of Money Market

Money market is an important part of the economy. It plays very significant functions. As mentioned above it is basically a market for short term monetary transactions. Thus it has to provide facility for adjusting liquidity to the banks, business corporations, non-banking financial institutions (NBFs) and other financial institutions along with investors.

The major functions of money market are given below:-

1. To maintain monetary equilibrium. It means to keep a balance between the demand for and supply of money for short term monetary transactions.
2. To promote economic growth. Money market can do this by making funds available to various units in the economy such as agriculture, small scale industries, etc.

3. To provide help to Trade and Industry. Money market provides adequate finance to trade and industry. Similarly it also provides facility of discounting bills of exchange for trade and industry.
4. To help in implementing Monetary Policy. It provides a mechanism for an effective implementation of the monetary policy.
5. To help in Capital Formation. Money market makes available investment avenues for short term period. It helps in generating savings and investments in the economy.
6. Money market provides non-inflationary sources of finance to government. It is possible by issuing treasury bills in order to raise short loans. However this dose not leads to increases in the prices.

Apart from those, money market is an arrangement which accommodates banks and financial institutions dealing in short term monetary activities such as the demand for and supply of money

1.5 PLAYERS OF MONEY MARKET

In money market transactions of large amount and high volume take place. It is dominated by small number of large players. In money market the players are:-Government, RBI, DFHI (Discount and finance House of India) Banks, Mutual Funds, Corporate Investors, Provident Funds, PSUs (Public Sector Undertakings), NBFCs (Non-Banking Finance Companies) etc.

The role and level of participation by each type of player differs from that of others.

1.6 FUNCTIONS OF MONEY MARKET

1. To maintain monetary equilibrium. It means to keep a balance between the demand for and supply of money for short term monetary transactions.
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6. Money market provides non-inflationary sources of finance to government. It is possible by issuing treasury bills in order to raise short loans. However this dose not leads to increases in the prices.
7. To caters to the short-term financial needs of the economy.
8. To helps the RBI in effective implementation of monetary policy.
9. To helps in allocation of short term funds through inter-bank transactions and money market Instruments.
10. Provides funds in non-inflationary way to the government to meet its deficits.

1.7 STRUCTURE OF INDIAN MONEY MARKET

Organized Sector	Unorganized Sector
Call and Notice Money Market	Indigenous Bankers
Treasury bill Market	Money Lenders
Commercial Bills	NBFI
Certificate of Deposits	
Commercial Papers	
Money Market Mutual Funds	
The REPO Market	
DFHI	

I. **Organized Sector of Money Market**:-Organized Money Market is not a single market, it consist of number of markets. The most important feature of money market instrument is that it is liquid. It is characterized by high degree of safety of principal. Following are the instruments which are traded in money market

1) **Call and Notice Money Market**:-The market for extremely short-period is referred as call money market. Under call money market, funds are transacted on overnight basis. The participants are mostly banks. Therefore, it is also called Inter-Bank Money Market. Under notice money market funds are transacted for 2 days and 14 days' period. The lender issues a notice to the borrower 2 to 3 days before the funds are to be paid. On receipt of notice, borrowers have to repay the funds.

   In this market the rate at which funds are borrowed and lent is called the call money rate. The call money rate is determined by demand and supply of short term funds. In call money market the main participants are commercial banks, co-operative banks and primary dealers. They participate as borrowers and lenders. Discount and Finance House of India (DFHI), Non-banking financial institutions like LIC, GIC, UTI, NABARD etc. are allowed to participate in call money market as lenders.

Call money markets are located in big commercial centers like Mumbai, Kolkata, Chennai, Delhi etc. Call money market is the indicator of liquidity position of money market. RBI intervenes in call money market as there is close link between the call money market and other segments of money market.

2) **Treasury Bill Market (T-Bills):-**This market deals in Treasury Bills of short term duration issued by RBI on behalf of Government of India. At present three types of treasury bills are issued through auctions, namely 91 day, 182 day and364day treasury bills. State government does not issue any treasury bills. Interest is determined by market forces. Treasury bills are available for a minimum amount of Rs. 25,000 and in multiples of Rs. 25,000. Periodic auctions are held for their Issue.

   T-bills are highly liquid, readily available; there is absence of risk of default. In India T-bills have narrow market and are undeveloped. Commercial Banks, Primary Dealers, Mutual Funds, Corporate, Financial Institutions, Provident or Pension Funds and Insurance Companies can participate in T-bills market.

3) **Commercial Bills:-**Commercial bills are short term, negotiable and self-liquidating money market instruments with low risk. A bill of exchange is drawn by a seller on the buyer to make payment within a certain period of time. Generally, the maturity period is of three months. Commercial bill can be resold a number of times during the usance period of bill. The commercial bills are purchased and discounted by commercial banks and are rediscounted by financial institutions like EXIM banks, SIDBI, IDBI etc.

In India, the commercial bill market is very much under-developed. RBI is trying to develop the bill market in our country. RBI has introduced an innovative instrument known as "Derivative. Usance Promissory Notes, with a view to eliminate movement of papers and to facilitate multiple rediscounting.

4) **Certificate Of Deposits (CDs):-**CDs are issued by Commercial banks and development financial institutions. CDs are unsecured, negotiable promissory notes issued at a discount to the face value. The scheme of CDs was introduced in 1989 by RBI. The main purpose was to enable the commercial banks to raise funds from market. At present, the maturity period of CDs ranges from 3 months to 1 year. They are issued in multiples of Rs. 25 lakh subject to a minimum size of Rs. 1 crore. CDs can be issued at discount to face value. They are freely transferable but only after the lock-in-period of 45 days after the date of issue.

   In India the size of CDs market is quite small. In 1992, RBI allowed four financial institutions ICICI, IDBI, IFCI and IRBI to issue CDs with a maturity period of. one year to three years.

5) **Commercial Papers (CP):-**Commercial Papers were introduced in January 1990. The Commercial Papers can be issued by listed companies which have working capital of not less than Rs. 5 crores. They could be issued in multiple of Rs. 25 lakhs. The minimum size of issue being Rs. 1 crore. At present the maturity period of CPs ranges between 7 days to 1 year. CPs are issued at a discount to its face value and redeemed at its face value.

6) **Money Market Mutual Funds (MMMFs):-**A Scheme of MMMFs was introduced by RBI in 1992. The goal was to provide an additional short-term avenue to individual

investors. In November 1995 RBI made the scheme more flexible. The existing guidelines allow banks, public financial institutions and also private sector institutions to set up MMMFs. The ceiling of Rs. 50 crores on the size of MMMFs stipulated earlier, has been withdrawn. MMMFs are allowed to issue units to corporate enterprises and others on par with other mutual funds. Resources mobilised by MMMFs are now required to be invested in call money, CD, CPs, Commercial Bills arising out of genuine trade transactions, treasury bills and government dated securities having an unexpired maturity upto one year. Since March 7, 2000 MMMFs have been brought under the purview of SEBI regulations. At present there are 3 MMMFs in operation.

7) **The Repo Market:-**Repo was introduced in December 1992. Repo is a repurchase agreement. It means selling a security under an agreement to repurchase it at a predetermined date and rate. Repo transactions are affected between banks and financial institutions and among bank themselves, RBI also undertake Repo.

   In November 1996, RBI introduced Reverse Repo. It means buying a security on a spot basis with a commitment to resell on a forward basis. Reverse Repo transactions are affected with scheduled commercial banks and primary dealers.

   In March 2003, to broaden the Repo market, RBI allowed NBFCs, Mutual Funds, Housing Finance and Companies and Insurance Companies to undertake REPO transactions.

8) **Discount And Finance House Of India (DFHI)** In 1988, DFHI was set up by RBI. It is jointly owned by RBI, public sector banks and all India financial institutions which have contributed to its paid up capital.It is playing an important role in developing an active secondary market in Money Market Instruments. In February 1996, it was accredited

as a Primary Dealer (PD). The DFHI deals in treasury bills, commercial bills, CDs, CPs, short term deposits, call money market and government securities.

II. **Unorganized Sector of Money Market:-**The economy on one hand performs through organized sector and on other hand in rural areas there is continuance of unorganized, informal and indigenous sector. The unorganized money market mostly finances short-term financial needs of farmers and small businessmen. The main constituents of unorganized money market are:-

1) **Indigenous Bankers (IBs)** Indigenous bankers are individuals or private firms who receive deposits and give loans and thereby operate as banks. IBs accept deposits as well as lend money. They mostly operate in urban areas, especially in western and southern regions of the country. The volume of their credit operations is however not known. Further their lending operations are completely unsupervised and unregulated. Over the years, the significance of IBs has declined due to growing organized banking sector.

2) **Money Lenders (MLs)** they are those whose primary business is money lending. Money lending in India is very popular both in urban and rural areas. Interest rates are generally high. Large amount of loans are given for unproductive purposes. The operations of money lenders are prompt, informal and flexible. The borrowers are mostly poor farmers, artisans, petty traders and manual workers. Over the years the role of money lenders has declined due to the growing importance of organized banking sector.

3) **Non-Banking Financial Companies (NBFCs)**
   They consist of:-

   1. Chit Funds: Chit funds are savings institutions. It has regular members who make periodic subscriptions to the

fund. The beneficiary may be selected by drawing of lots. Chit fund is more popular in Kerala and Tamilnadu. Rbi has no control over the lending activities of chit funds.

2. Nidhis:-Nidhis operate as a kind of mutual benefit for their members only. The loans are given to members at a reasonable rate of interest. Nidhis operate particularly in South India.

3. Loan Or Finance Companies: Loan companies are found in all parts of the country. Their total capital consists of borrowings, deposits and owned funds. They give loans to retailers, wholesalers, artisans and self-employed persons. They offer a high rate of interest along with other incentives to attract deposits. They charge high rate of interest varying from 36% to 48% p.a.

4. Finance Brokers: They are found in all major urban markets specially in cloth, grain and commodity markets. They act as middlemen between lenders and borrowers. They charge commission for their services.

1.8 FEATURES I DEFICIENCIES OF INDIAN MONEY MARKET

Indian money market is relatively underdeveloped when compared with advanced markets like New York and London Money Markets. Its' main features/defects are as follows

1. Dichotomy:

A major feature of Indian Money Market is the existence of dichotomy i.e. existence of two markets:-Organized Money Market and Unorganized Money Market. Organized Sector consist of RBI, Commercial Banks, Financial Institutions etc. The Unorganized Sector consist of IBs, MLs, Chit Funds, Nidhis etc. It is difficult for RBI to integrate the Organized and Unorganized

Money Markets. Several segments are loosely connected with each other. Thus there is dichotomy in Indian Money Market.

2. Lack Of Co-ordination and Integration:

It is difficult for RBI to integrate the organized and unorganized sector of money market. RBT is fully effective in organized sector but unorganized market is out of RBI's control. Thus there is lack of integration between various sub-markets as well as various institutions and agencies. There is less co-ordination between co-operative and commercial banks as well as State and Foreign banks. The indigenous bankers have their own ways of doing business.

3. Diversity In Interest Rates:

There are different rates of interest existing in different segments of money market. In rural unorganized sectors the rate of interest are high and they differ with the purpose and borrower. There are differences in the interest rates within the organized sector also. Although wide differences have been narrowed down, yet the existing differences do hamper the efficiency of money market.

4. Seasonality Of Money Market:-

Indian agriculture is busy during the period November to June resulting in heavy demand for funds. During this period money market suffers from Monetary Shortage resulting in high rate of interest. During slack season rate of interest falls &s there are plenty of funds available. RBI has taken steps to reduce the seasonal fluctuations, but still the variations exist.

5. Shortage Of Funds:-

In Indian Money Market demand for funds exceeds the supply. There is shortage of funds in Indian Money Market an account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy etc. There is also vast amount of black money in the country which has caused shortage of funds. However, in recent years development of banking has improved the mobilization of funds to some extent.

6. Absence Of Organized Bill Market:-

A bill market refers to a mechanism where bills of exchange are purchased and discounted by banks in India. A bill market provides short term funds to businessmen. The bill market in India is not popular due to overdependence of cash transactions, high discounting rates, problem of dishonor of bills etc.

7. Inadequate Banking Facilities:-

Though the commercial banks, have been opened on a large scale, yet banking facilities are inadequate in our country. The rural areas are not covered due to poverty. Their savings are very small and mobilization of small savings is difficult. The involvement of banking system in different scams and the failure of RBI to prevent these abuses of banking system shows that Indian banking system is not yet a well organized sector.

8. Inefficient And Corrupt Management:-

One of the major problem of Indian Money Market is its inefficient and corrupt management. Inefficiency is due to faulty selection, lack of training, poor performance appraisal, faulty promotions etc. For the growth and success of money market, there is need for well trained and dedicated workforce in banks. However, in India some of the bank officials are inefficient and corrupt.

1.9 CAPITAL MARKET IN INDIA:-

Capital market deals with medium term and long term funds. It refers to all facilities and the institutional arrangements for borrowing and lending term funds (medium term and long term). The demand for long term funds comes from private business corporations, public corporations and the government. The supply of funds comes largely from individual and institutional investors, banks and special industrial financial institutions and Government.

STRUCTURE I CONSTITUENTS I CLASSIFICATION OF CAPITAL MARKET

Capital market is classified in two ways

CAPITAL MARKET IN INDIA

Gild–Edged Market	Industrial Securities Market	Development Financial Institutions (DFIs)	Financial intermediaries

a) Gilt-Edged Market:-
Gilt-Edged market refers to the market for government and semi-government securities, which carry fixed rates of interest. RBI plays an important role in this market.

b) Industrial Securities Market:-
It deals with equities and debentures in which shares and debentures of existing companies are traded and shares and debentures of new companies are bought and sold.

c) Development Financial Institutions:-
Development financial institutions were set up to meet the medium and long-term requirements of industry, trade and agriculture. These are IFCI, ICICI, IDBI, SIDBI, IRBI, UTI, LIC, GIC etc. All These institutions have been called Public Sector Financial Institutions.

d) Financial Intermediaries:-
Financial Intermediaries include merchant banks, Mutual Fund, Leasing companies etc. they help in mobilizing savings and supplying funds to capital market.

The Second way in which capital market is classified is as follows:-

a) Primary Market:-
Primary market is the new issue market of shares, preference shares and debentures of non-government public limited companies and issue of public sector bonds.

b) Secondary Market
This refers to old or already issued securities. It is composed of industrial security market or stock exchange market and gilt-edged market.

ROLE AND IMPORTANCE OF CAPITAL MARKET IN INDIA

Capital market has a crucial significance to capital formation. For a speedy economic development adequate capital formation is necessary. The significance of capital market in economic development is explained below:-

1. Mobilisation Of Savings And Acceleration Of Capital Formation:-
In developing countries like India the importance of capital market is self evident. In this market, various types of securities helps to mobilise savings from various sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

2. Raising Long-Term Capital:-
The existence of a stock exchange enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this dash of interests by offering

an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.

3. Promotion Of Industrial Growth:-
   The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

4. Ready And Continuous Market:-
   The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.

5. Technical Assistance:-
   An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.

6. Reliable Guide To Performance:-
   The capital market serves as a reliable guide to the performance and financial position of corporate, and thereby promotes efficiency.

7. Proper Channelization Of Funds:-
   The prevailing market price of a security and relative yield are the guiding factors for the people to channelize their funds in a particular company. This ensures effective utilization of funds in the public interest.

8. Provision Of Variety Of Services:-
   The financial institutions functioning in the capital market provide a variety of services such as grant of long term and medium term loans to entrepreneurs, provision of underwriting facilities, assistance in promotion of companies, participation in equity capital, giving expert advice etc.

9. Development Of Backward Areas:-
   Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long term funds are also provided for development projects in backward and rural areas.

10. Foreign Capital:-
    Capital markets makes possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalized Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.

11. Easy Liquidity:-
    With the help of secondary market investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

12. Revival Of Sick Units:-
    The Commercial and Financial Institutions provide timely financial assistance to viable sick units to overcome their industrial sickness. To help the weak units to overcome their financial industrial sickness banks and FIs may write off a part of their loan.

GROWTH OF CAPITAL MARKET IN INDIA

End of December	1975-76	2004-05
i) Stock Exchanges (No.)	8	23
ii) Market Value of Capital (in Crore)	3,273	16,98,428
iii) Capital Issues (Rs. in Crore)	98	60,502
iv) Capital raised as % of gross domestic saying(%)	0.7	7.0

Source:-Tata Services Ltd., statistiscal outline of India 2005-06.

After Independence capital market has shown a remarkable progress. The first organized stock exchange was established in India at Bombay in 1887. When the Securities Contracts (Regulation) Act 1956 was passed, only 7 Stock exchanges Viz. Mumbai, Ahmedabad, Kolkata, Chennai, Delhi, Hyderabad and Indore, received recognition. By end of March 2004, the number of stock exchanges increased to 23.

1) Primary I New Issues Market:-

After liberalisation policy of 1991 and the abolition of capital issues control with effect from May 29,1992, the primary market got a tremendous, boost. This can be seen from following points:-

a) New Capital Issues by Private Sector:-

The number of new capital issues by private sector was only 364 in 1990-91 and the amount raised by them was `.4,312 crore. The number of new capital issues rose to 1,678 in 1994-95 and the amount raised by them was `. 26,418 crore. Since 1995 the capital market was sluggish and the resources raised fell to `.. 10,409 crores in 1996-97. In 2003-04, the amount raised from new capital issues was only `.3,210 crores. In 2004 it increased again to `.33,475 crore and in 2005`.30,325 crore of resources were raised on this market. The primary issues of debt securities felt a low of around `. 66 crore in 2005.

b) Public Sector Bonds:-

The resources raised by issuing bonds by Public Sector undertakings rose from `.354 crores in 1985-86 to 7,491 crore in 2004-05.

c) Mutual Funds:-

In 1997-98, the total number of mutual funds in the country was 34. In 1997-98, the mutual funds were able to mobilise `.4,064 crore. In 1999-2000 mutual funds mobilised a record of `.22,117 crore. There was a massive resource mobilisation of `..41,570 crore by private sector mutual funds in 2003-04, pushing up the total resource mobilisation by all mutual funds to as high as `.47,873 crore. In 2004-05, resource mobilisation once again declined to `.3,015 crore.

2) Secondary Market:-

a) Industrial Securities Market:-

In 1991-92, there was an huge rise in the share prices. The RBI All India Index Number of Ordinary Share Prices rose to 1,485.4 in 1991-92 (base year 1980-81), showing a gain of 181.4%. In 1992-93 due to irregularities the Stock Market declined. The years 1993 and 1994 saw increased activity in stock market due to:-Better performance of companies, Improvement in Balance of Payment position, Increasing investment by Foreign Institutional investors etc. India enjoys 2nd.largest investor population in the world next to U.S.A.

b) Bombay Stock Exchange (BSE):-

The scrip movements In Bombay Stock Exchange reflected the same trend as the RBI index (BSE sensitive index with base 1978-79 = 100). Market capitalisation of Bombay Stock Exchange was`.12, 01,207 crore in 2003-04. It rose to `.30, 66,076 crore in 2008-09.

c) National Stock Exchange (NSE):-

The NSE of India was set up in 1992 and started its operations in 1994. It provides facility for trading of equity investments, warrants, debentures, preference shares etc. The market capitalisation of NSE reached to `.28, 96,194 crore in 2008-09.

d) Over The Counter Of Exchange Of India:-

It was set in August 1989 and started .operating since 1992.

e) Financial Intermediaries:-

Financial Intermediaries are the latest trend in Indian Capital Market. They have to play an important role in field of venture capital, credit rating etc.

1.10 FACTORS CONTRIBUTING TO THE GROWTH AND DEVELOPMENT OF CAPITAL MARKET

1) Growth Of Development Banks And Financial Institutions:-

For providing long term funds to industry, the government set up Industrial Finance Corporation in India (IFCI) in 1948. This was followed by a number of other development banks and institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, Foreign Investment Promotion Board in 1991, Over the Counter Exchange of India (OTCEI) in 1992 etc. In 1969, 14 major commercial banks were nationalised. Another 6 banks were nationalised in 1980. These financial institutions and banks have contributed in widening and strengthening of capital market in India.

2) Setting Up Of SEBI:-

The Securities Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992.

3) Credit Rating Agencies:-

Credit rating agencies provide guidance to investors/creditors for determining the credit risk. The Credit Rating Information Services of India Limited (CRISIL) was set up in 1988 and Investment Information and Credit Rating Agency of India Ltd. (ICRA) was set up in 1991. These agencies are likely to help the development of capital market in future.

4) Growth Of Mutual Funds:-

The mutual funds collects funds from public and other investors and channelise them into corporate investment in the primary and secondary markets. The first mutual fund to be set up in India was Unit Trust of India in 1964. In 2007-08 resources mobilised by mutual funds were Rs. 1,53,802 crores.

5) Increasing Awareness:-

During the last few years there have been increasing awareness of investment opportunities among the public. Business newspapers and financial journals (The Economic Times, The Financial Express, Business India, Money etc.) have made the people aware of new long-term investment opportunities in the security market.

6) Growing Public Confidence

A large number of big corporations have shown impressive growth. This has helped in building up the confidence of the public. The small investors who were not interested to buy securities from the market are now showing preference in favour of shares and debentures. As a result, public issues of most of the good companies are now over-subscribed many times.

7) Legislative Measures:-

The government passed the companies Act in 1956. The Act gave powers to government to control and direct the development of the corporate enterprises in the country. The capital Issues (control) Act was passed in 1947 to regulate investment in different enterprises, prevent diversion of funds to non-essential activities and to protect the interest of investors. The Act was replaced in 1992.

8) Growth Of Underwriting Business:-

The growing underwriting business has contributed significantly to the development of capital market.

9) Development Of Venture Capital Funds:-

Venture capital represents financial investment in highly risky projects with a hope of earning high returns After 1991, economic liberalisation has made possible to provide medium and long term funds to those firms, which find it difficult to raise funds from primary markets and by way of loans from FIs and banks.

10) Growth Of Multinationals (MNCs):-

The MNCs require medium and long term funds for setting up new projects or for expansion and modernization. For this purpose, MNCs raise funds through loans from banks and FIs. Due to the presence of MNCs, the capital market gets a boost.

11) Growth Of Entrepreneurs:-

Since 1980s, there has been a remarkable growth in the number of entrepreneurs. This created more demand for short term and long term funds. FIs, banks and stock markets enable the entrepreneurs to raise the required funds. This has led to the growth of capital market in India.

12) Growth Of Merchant Banking:-

The credit for initiating merchant banking services in India goes to Grindlays Bank in 1967,followed by Citibank in 1970. Apart from capital issue management, merchant banking divisions provide a number of other services including provision of consultancy services relating to promotion of projects, corporate restructuring etc.

1.11 REFORMS I DEVELOPMENTS IN CAPITAL MARKET SINCE 1991:-

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

1) Securities And Exchange Board of India (SEBI):-

SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India. The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

2) National Stock Exchange (NSE):-

The setting up to NSE is a landmark in Indian capital markets. At present, NSE is the largest stock market in the country. Trading on NSE can be done throughout the country through the network of satellite terminals. NSE has introduced inter-regional clearing facilities.

3) Dematerialisation Of Shares:-

Demat of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds and debentures are allowed in demat form. The advantage of demat trade is that it involves Paperless trading.

4) Screen Based Trading:-

The Indian stock exchanges were modernized in 90s, with Computerized Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

5) Investor Protection:-

The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001: The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment. The IEPF will be utilised for promotion of awareness amongst investors and protection of their interests.

6) Rolling Settlement:-

Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled› under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets.

7) The Clearing Corporation Of India Limited (CCIL):-

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee/US $ forex spot and forward deals All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, white those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

8) The National Securities Clearing Corporation Limited (NSCL):-

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

9) Trading In Central Government Securities:-

In order to encourage wider participation of all classes of investors, Including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nation wide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

10) Credit Rating Agencies:-

Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL–1988), Investment Information and credit Rating Agency of India Ltd. (ICRA–1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

11) Accessing Global Funds Market:-

Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository

Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIIs), and Overseas Corporate Bodies (OCBs).

12) Mutual Funds:-

Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services/advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

13) Internet Trading:-

Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

14) Buy Back Of Shares:-

Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

15) Derivatives Trading:-

Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, Index Options. Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

16) PAN Made Mandatory:-

In order to strengthen the "Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007.

1.12 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI):-

SEBI was established as a non-statutory board in 1988 and in January 1992 it was made a Statutory body. The main objectives of SEBI are

1) To protect the interest of investors.
2) To bring professionalism in the working of intermediaries in capital markets (brokers, mutual funds, stock exchanges, demat depositories etc.).
3) To create a good financial climate, so that companies can raise long term funds through issue of securities (shares and debentures)

In 2002, SEBI is further empowered to do the following:-

1. To file complaints in courts and to notify its regulations without prior approval of government.
2. To regulate issue of capital and transfer of securities.
3. To impose monetary penalties on various intermediaries and other participants for a specified range of violations.
4. To issue direction to and to call for documents from all intermediaries.

A. ROLE/POWERS AND FUNCTIONS OF SEBI:-

1. Protection Of Investor's Interest:-

SEBI frames rules and regulations to protect the interest of investors. It monitors whether the rules and regulations are being followed by the concerned parties i.e., issuing companies, mutual funds, brokers and others. It handles investor grievances or complaints against brokers, securities issuing companies and others.

2. **Restriction On Insider Trading:-**

   SEBI restricts insider trading activity. It prohibits dealing, communication or counselling on matters relating to insider trading. SEBI's regulation states that no insider (connected with the company) shall-either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information.

3. **Regulates Stock Brokers Activities:-**

   SEBI has also laid down regulations in respect of brokers and sub-broker. No brokers or sub-broker can buy, sell or deal in securities without being a registered member of SEBI. It has also made compulsory for brokers to maintain separate accounts for their clients and for themselves. They must also have their books audited and audit reports filed with SEBI.

4. **Regulates Merchant Banking:-**

   SEBI has laid down regulations in respect of merchant banking activities in India. The regulations are in respect of registration, code of conduct to be followed, submission of half-yearly results and so on

5. **Dematerialisation Of Shares:-**

   Demat of shares has been introduced in all the shares traded on secondary stock markets as well as those issued to public in prirriary markets. Even bonds and debentures are allowed in demat form.

6. **Guidelines On Capital Issues:-**

   SEBI has framed necessary guidelines in connection with capital issues. The guidelines are applicable to:-First Public

Issue of New Companies, First Public Issue by Existing Private/ Closely held Companies, Public Issue by Existing Listed Companies.

7. Regulates Working Of Mutual Funds:-

SEBI regulates the working of mutual funds. SEBI has laid down rules and regulations that are to be followed by mutual funds. SEBI may cancel the registration of a mutual fund, if it fails to comply with the regulations.

8. Monitoring Of Stock Exchanges:-

To improve the working of stock markets, SEBI plays an important role in monitoring stock exchanges. Every recognised stock exchange has to furnish to SEBI annually with a report about its activities during the previous year.

9. Secondary Market Policy:-

SEBI is responsible for all policy and regulatory issues for secondary market and new investments products. It is responsible for registration and monitoring of members of stock exchanges, administration of some of stock exchanges and monitoring of price movements and insider trading.

10. Investors Grievances Redressal:-

SEBI has introduced an automated complaints handling system to deal with investor complaints. It assist investors who want to make complaints to SEBI against listed companies.

11. Institutional Investment Policy:-

SEBI looks after institutional investment policy with respect to domestic mutual funds and Foreign Institutional Investors (FIIs). It also looks after registration, regulation and monitoring of FIIs and domestic mutual funds.

12. Takeovers And Mergers:-

To protect the interest of investors in case of takeovers and mergers SEBI has issued a set of guidelines. These guidelines are to be followed by corporations at the time of takeovers and mergers.

13. Reforms In Capital Market:-

SEBI has introduced many reforms in Capital Market. Some of them are:-

a) Demat of shares
b) PAN made compulsory.
c) Buy back of shares allowed.
d) Corporate Governance introduced
e) Transparency rules in Brokers Transactions.

14. Other Functions:-

a) It promotes investor's education, and also training of intermediaries in securities market.
b) It performs functions and exercise powers under provisions of Capital Issues (Control) Act 1947, Securities Contracts Act 1956 etc.
c) It promotes and regulates self-regulatory organisations.
d) It prohibits fraudulent and unfair trade practices in securities Market
e) It promotes investors education and training in securities market.

B. APPRAISAL OF SEBI›S WORK:-

1) Large Number Of Rules:-

There are large .number of rules prescribed by SEBI. These have also been changing from time to time. This has created a high level of uncertainty and confusion. It is very difficult to determine what rules are currently in operation.

2) Less Protection To Small Investors:-
   SEBI is not really serious about reforming the system and protecting the individual and small investors. It has failed to penalise the people responsible for causing abnormal price fluctuations on stock market.

3) False Claim On High Success Rate:-
   SEBI's Annual Report, in 1995-96 claims, a very high success rale in resolving investor complaints. But in reality it is not so.

4) Insufficient Power:-
   SEBI has often complained of having insufficient authority and power. It should become more effective, efficient, socially-accountable and small-investor-friendly. working is quite good. Liquidity in market has improved various segments have also become interlinked. It provides a world class trading and' settlement system.

5) Corporate–Friendly regulation:-
   The regulatory ineffectiveness of SEBI in certain areas has been due to its concentration on symptoms rather than the root causes.

C. POLICY MEASURES BY SEBI:-

1) Entry Norms:-
   SEBI has issued various guidelines for tightening the entry norms for companies accessing capital market.

2) Norms For Share Transfer:-
   SEBI has tightened the norms for transfer of shares among group companies and takeover of companies.

3) Penal Margins:-
   SEBI has introduced imposition of penal margin on net undelivered portion at the end of settlement.

4) Screen Based Trading:-
SEBI allowed stock exchanges to expand their online screen based trading terminals to-locations outside their jurisdiction subject to conditions.

5) Intermediaries:-
SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustee of trust funds, registrars to an issue, merchant banks, underwriters and other intermediaries who may be associated with securities market.

6) Prohibition Of Fraudulent And Unfair Practices:-
SEBI regulates prohibition of Fraudulent and unfair trade practices which have imposed prohibition against market manipulators and unfair practices relating to securities.

7) Steps To Improve Corporate Governance:-
Sufficient disclosures are made mandatory for companies at the stage of public issue. Listed companies are required to make disclosures on continuing basis on dividend, bonus etc.

8) Comprehensive Risk Management And Improvement In Disclosure:-
In July 2002, SEB| set up a system EDIFAR (Electronic Data Information Filing And Retrieval) through which firms would electronically file mandatory disclosures to SEBI and these documents would be available to individuals across the country over the Internet, with a near-zero delay.

9) Raising Funds From Abroad:-
Indian companies are allowed to raise funds from abroad, through American/Global Depository Receipts, Foreign Currency Convertible Bonds.and External Commercial Borrowings.

10) Norms For Custodian Of Securities And Depositories:-
SEBI notified two regulations namely, Custodian of Securities Regulation, and Depositories and Participant Regulations.

CH. 2

INDIAN FINANCIAL SYSTEM-OVERVIEW

Meaning and Definition of Financial System:

The financial system is possibly the most important institutional and functional vehicle for economic transformation. Finance is a bridge between the present and the future and whether the mobilization of savings or their efficient, effective and equitable allocation for investment, it the access with which the financial system performs its functions that sets the pace for the achievement of broader national objectives.

According to Christy, the objective of the financial system is to "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth.

A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the deficit. It is a composition of various institutions, markets, regulations and laws, practices, money manager analyst, transactions and claims and liabilities.

Features of financial system

The features of a financial system are as follows

1. Financial system provides an ideal linkage between depositors and investors, thus encouraging both savings and investments.
2. Financial system facilitates expansion of financial markets over space and time.
3. Financial system promotes efficient allocation of financial resources for socially desirable and economically productive purposes.

4. Financial system influences both the quality and the pace of economic development.

2.1 CONSTITUENTS OF FINANCIAL SYSTEM

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

1. **Financial institutions:** Financial institutions are intermediaries that mobilize savings & facilitate the allocation of funds in an efficient manner.

   Financial institutions can be classified as banking & non-banking financial institutions. Banking institutions are creators of credit while non-banking financial institutions are purveyors of credit. While the liabilities of banks are part of the money supply, this may not be true of non-banking financial institutions. In India, non-banking financial institutions, namely, the developmental financial institutions (DFIs) & non-banking financial companies (NBFCs) as well as housing finance companies (HFCs) are the major institutional purveyors of credit. Financial institutions can also be classified as term-finance institutions such as the industrial development bank of India (IDBI), industrial credit & Investment Corporation of India (ICICI), industrial financial corporation of India (IFCI), small industries development bank of India (SIDBI) & industrial investment bank of India (IIBI).

2. **Financial markets:**

   Financial markets are a mechanism enabling participants to deal in financial claims.

   The markets also provide a facility in which their demands & requirements interact to set a price for such claims. The main organized financial markets in India are the money market &

capital market. The first is a market for short-term securities. Money market is a market for dealing with financial assets & securities which have a maturity period of upto one year. While the second is a market for long term securities, that is, securities having a maturity period of one year or more. The capital market is a market for financial assets which have a long or indefinite maturity.

Money market consists of:

Call money market:

Call money market is a market for extremely short period loans say one day to fourteen days. It is highly liquid.

Commercial bills market:

It is a market for bills of exchange arising out of genuine trade transactions. In the case of credit sale, the seller may draw a bill of exchange on the buyer. The buyer accepts such a bill promising to pay at a later date the amount specified in the bill. The seller need not wait until the due date of the bill. Instead, he can get immediate payment by discounting the bill.

Treasury bills market:

It is a market for treasury bills which have 'short-term' maturity. A treasury bill is a promissory note or a finance bill issued by the government. It is highly liquid because its repayment is guaranteed by the government.

Short-term loan market:

It is a market where short-term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play a significant role in this market.

Capital market consists of:

Industrial securities market:

It is a market for industrial securities namely equity shares or ordinary shares, preference shares & debentures or bonds. It is a market where industrial concerns raise their capital or debt by issuing appropriate instruments. It can be further subdivided into primary & secondary market.

Government securities market:

It is otherwise called gilt-edged securities market. It is a market where government securities are traded. In India there are many kinds of govt securities-short-term & long-term. Long-term securities are traded in this market while short term securities are traded in the money market.

Long-term loans market:

Development banks & commercial banks play a significant role in this market by supplying long term loans to corporate customers. Long-term loans market may further be classified into:
Term loans market
Mortgages market
Financial guarantees market

3. Financial Instruments:

A financial instrument refers to those documents which represents financial claims on assets. As discussed earlier, financial assets refers to a claim to the repayment of certain sum of money at the end of specified period together with interest or dividend. Examples: bills of exchange, promissory notes, treasury bills, government bonds, deposit receipts, shares debentures etc.

Financial instruments can also be called financial securities. Financial securities can be classified into:

i. Primary or direct securities
ii. Secondary or indirect securities.

Primary securities

These are securities directly issued by the ultimate investors to the ultimate savers. Examples, shares and debentures issued directly to the public.

Secondary securities

These are securities issued by some intermediaries called financial intermediaries to the ultimate savers. E.g. unit trust of India and Mutual funds issue securities in the form of units to the public and money pooled is invested in companies.

Again these securities may be classified on the basis of duration as follows:

i. Short-term securities
ii. Medium-term securities
iii. Long-term securities.

Short-term securities are those which mature within a period of one year. E.g. Bills of exchange, treasury bills, etc. medium term securities are those which have a maturity period ranging between one and five years.

e.g. Debentures maturing within a period of 5 years. Long-term securities are those which have a maturity period of more than five years. E.g. government Bonds maturing after 10 years.

Characteristic Features of Financial Instruments

Generally speaking, financial instruments possess the following characteristic features:

i. Most of the instruments can be easily transferred from one hand to another without many cumbersome formalities.
ii. They have a ready market, i.e., they can be bought and sold frequently and thus, trading in these securities is made possible.
iii. They possess liquidity, i.e., some instruments can be converted into cash readily. For instance, a bill of exchange can be converted into cash readily by means of discounting and rediscounting.
iv. Most of the securities posses security value, i.e., they can be given as security for the purpose of raising loans.
v. Some securities enjoy tax status, i.e., investment in these securities are exempted from income tax, wealth tax, etc., subject to certain limits. E.g. public sector tax free bonds, magnum tax saving certificates.
vi. They carry risk in the sense that there is uncertainty with regard to the payment of principle or interest or dividend as the case may be.
vii. These instruments facilitate future trading so as to cover risks due to price fluctuations, interest rates, etc.
viii. These instruments involve less handling costs since expenses involved in buying and selling these securities are generally much less.
ix. The return on these instruments is directly in proportion to the risk undertaken.
x. These instruments may be short-term or medium term or long term depending upon the maturity period of these instruments.

4. Financial Services:

Financial intermediaries provide key financial services such as merchant banking, leasing hire purchases, credit-rating, and so on. Financial services rendered by the financial intermediaries bridge the gap between lack of knowledge on the part of investors and increasing sophistication of financial instruments and markets. These financial services are vital for creation of firms, industrial expansion, and economic growth.

Before investors lend money, they need to be reassured that it is safe to exchange securities for funds. This reassurance is provided by the financial regulator, who regulates the conduct of the market, and intermediaries to protect the investors' interests. The Reserve Bank of India regulates the money market and Securities Exchange Board of India (SEBI) regulates capital market.

2.2 FUNCTIONS OF INDIAN FINANCIAL SYSTEM

Good financial system search in the following ways:

1. **Promotion of liquidity:**

   The major function of financial system is the provision of money and monetary assets for the production of goods and services. There should not be any shortage of money for productive ventures. In financial language, the money and monetary assets are referred to as liquidity. The term liquidity refers to cash or money and other assets which can be converted into cash readily without loss of value and time.

2. **Link between savers and investors:**

   One of the important functions of financial system is to link the savers and investors and thereby help in mobilizing and allocating the savings effectively and efficiently. By acting as an efficient medium for allocation of resources, it permits continuous up gradation of technologies for promoting growth on a sustained basis.

3. **Information available:**

   It makes available price-related information which is a valuable assistance to those who need economic and financial decision.

4. **Helps in projects selection:**

   A financial system not only helps in selecting projects to be funded but also inspires the operators to monitor the performance of the investment. It provides a payment mechanism for the exchange of goods and services, and transfers economic resources through time and across geographic regions and industries.

5. **Allocation of risk:**

   One of most important function of the financial system is to achieve optimum allocation of risk bearing. It limits, pools, and trades the risks involved in mobilizing savings and allocating credit. An effective financial system aims at containing risk within acceptable limit and reducing cost of gathering and analyzing information to assist operators in taking decisions carefully.

6. **Minimizes situations of Asymmetric information:**

   A financial system minimizes situations where the information is Asymmetric and likely to affect motivations among operators or when one party has the information and the other party does not. It provides financial services such as insurance and pension and offers portfolio adjustments facilities.

7. **Reduce cost of transaction and borrowing:**

   A financial system helps in creation of financial structure that lowers the cost of transactions. This has a beneficial influence on the rate of return to the savers. It also reduces the cost of borrowings. Thus, the system generates an impulse among the people to save more.

8. **Financial deepening and broadening:**

   A well–functioning financial system helps in promoting the process of financial deepening and broadening. Financial deepening refers to an increase of financial assets as a percentage of the gross domestic product. Financial broadening refers to building an increasing number and a variety of participants and instruments.

2.3 ROLE OF MONEY MARKET IN ECONOMY

Money markets play a key role in banks' liquidity management and the transmission of monetary policy. In normal times, money markets are among the most liquid in the financial sector. By providing the appropriate instruments and partners for liquidity trading, the money market allows the refinancing of short and medium-term positions and facilitates the mitigation of your business' liquidity risk. The banking system and the money market represent the exclusive setting monetary policy operates in.

A developed, active and efficient interbank market enhances the efficiency of central bank's monetary policy, transmitting its impulses into the economy best. Thus, the development of the money market smoothes the progress of financial intermediation and boosts lending to economy, hence improving the country's economic and social welfare.

Therefore, the development of the money market is in all stakeholders' interests: the banking system elf, the Central Bank and the economy on the whole.

2.4 PRODUCING INFORMATION AND ALLOCATING CAPITAL

The information production role of financial systems is explored by Ramakrishnan and Thakor (1984), Bhattacharya and P fleiderer (1985), Boyd and Prescott (1986), and Allen (1990). They develop models where financial intermediaries arise to produce information and sell this information to savers. Financial intermediaries can improve the ex ante assessment of investment opportunities with positive ramifications on resource allocation by economizing on information acquisition costs. As Schumpeter (1912) argued, financial systems can enhance growth by spurring technological innovation by identifying and funding entrepreneurs with the best chance of successfully implementing innovative procedures. For sustained growth at the frontier of technology, acquiring information and strengthening incentives for obtaining information to improve resource allocation become key issues.

A. RISK SHARING

One of the most important functions of a financial system is to achieve an optimal allocation of risk. There are many studies directly analyzing the interaction of the risk sharing role of financial systems and economic growth. These theoretical analyses clarify the conditions under which financial development that facilitates risk sharing promotes economic growth and welfare. Quite often in these studies, however, authors focus on either markets or intermediaries, or a comparison of the two extreme cases where every financing is conducted by either markets or intermediaries. The intermediate case in which markets and institutions co-exist is rarely analyzed in the context of growth models because the addition of markets can destroy the risk-sharing opportunities provided by intermediaries. In addition, studies focus on the role of financial systems that face diversifiable risks. The implications for financial development and financial structure on economic growth are potentially quite different when markets cannot diversify away all of the risks inherent in the economic environment. One importance of risk sharing on economic growth comes from the fact that wile avers generally do not like risk, high-return projects tend to be riskier than low return projects. Thus, financial markets that ease risk diversification tend to induce a portfolio shift onwards projects with higher expected returns as pointed out by Greenwood and Jovanovic(1990), Saint-Paul (1992), Devereux and Smith (1994) and Obstfeld (1994). King and Levine(1993a) show that cross sectional risk diversification can stimulate risky innovative activityfor sufficiently risk-averse agents. The ability to hold a diversified portfolio of innovative projects reduces risk and promotes investment in growth-enhancing innovative activities.

B. LIQUIDITY

Money market funds provide valuable liquidity by investing in commercial paper, municipal securities and repurchase agreements: Money market funds are significant participants in the commercial paper, municipal securities and repurchase agreement (or repo) markets. Money market funds hold almost 40% of all outstanding commercial paper, which is now the primary source for short-term funding for corporations, who issue commercial paper as a lower-cost alternative to short-term bank loans. The repo market is an important means by which the Federal Reserve conducts monetary policy and provides daily liquidity to global financial institutions. Quantum of liquidity in

Quantum of liquidity in the banking system is of paramount importance, as it is an important determinant of the inflation rate as well as the creation of credit by the banks in the economy. Market forces generally indicate the need for borrowing or liquidity and the money market adjusts itself to such calls. RBI facilitates such adjustments with monetary policy tools available with it. Heavy call for funds overnight indicates that the banks are in need of short term funds and in case of liquidity crunch, the interest rates would go up.

C. DIVERSIFICATION

For both individual and institutional investors, money market mutual funds provide a commercially attractive alternative to bank deposits. Money market funds offer greater investment diversification, are less susceptible to collapse than banks and offer investors greater disclosure on the nature of their investments and the underlying assets than traditional bank deposits. For the financial system generally, money market mutual funds reduce pressure on the FDIC, reduce systemic risk and provide essential liquidity to capital markets because of the funds' investments in commercial paper, municipal securities and repurchase agreements.

ENCOURAGEMENTS TO SAVING AND INVESTMENT

Money market has encouraged investors to save which results in encouragement to investment in the economy. The savings and investment equilibrium of demand and supply of loan able funds helps in the allocation of resources.

D. CONTROLS THE PRICE LINE IN ECONOMY

Inflation is one of the severe economic problems that all the developing economies have to face every now and then. Cyclical fluctuations do influence the price level differently depending upon the demand and supply situation at the given point of time. Money market rates play a main role in controlling the price line. Higher rates in the money markets decrease the liquidity in the economy and have the effect of reducing the economic activity in the system. Reduced rates on the other hand increase the liquidity in the market and bring down the cost of capital considerably, thereby raising the investment. This function also assists the RBI to control the general money supply in the economy.

E. HELPS IN CORRECTING THE IMBALANCES IN ECONOMY

Financial policy on the other hand, has longer term perspective and aims at correcting the imbalances in the economy. Credit policy and the financial policy both balance each other to achieve the long term goals strong-minded by the government. It not only maintains total control over the credit creation by the banks, but also keeps a close watch over it. The instruments of financial policy counting the repo rate cash reserve ratio and bank rate are used by the Central Bank of the country to give the necessary direction to the monetary policy.

F. REGULATES THE FLOW OF CREDIT AND CREDIT RATES

Money markets are one of the most significant mechanisms of any developing financial system. In its place of just ensure that the money market in India regulate the flow of credit and credit rates, this instrument has emerge as one of the significant policy tools with the government and the RBI to control the financial policy, money supply, credit creation and control, inflation rate and overall economic policy of the State. Therefore the first and the leading function of the money market mechanism are regulatory in nature. While determining the total volume of credit plan for the six monthly periods, the credit policy also aims at directing the flow of credit as per the priorities fixed by the government according to the requirements of the economy. Credit policy as an instrument is important to ensure the availability of the credit in sufficient volumes; it also caters to the credit needs of various sectors of the economy. The RBI assist the government to realize its policies related to the credit plans throughout its statutory control over the banking system of the country.

G. TRANSMISSION OF MONETARY POLICY

The money market forms the first and foremost link in the transmission of monetary policy impulses to the real economy. Policy interventions by the central bank along with its market operations influence the decisions of households and firms through the monetary policy transmission mechanism. The key to this mechanism is the total claim of the economy on the central bank, commonly known as the monetary base or highpowered money in the economy. Among the constituents of the monetary base, the most important constituent is bank reserves, i.e., the claims that banks hold in the form of deposits with the central bank. The banks' need for these reserves depends on the overall level of economic activity. This is governed by several factors: (i) Banks hold such reserves in proportion to the volume of deposits in many countries, known as reserve requirements, which influence their ability to extend credit and create deposits, thereby limiting the volume of transactions to be handled by the bank; (ii) bank's ability to make loans (asset of the bank) depends on its ability to mobilize deposits (liability of the bank) as total assets and liabilities of the bank need to match and expand/contract together; and (iii) Banks' need to hold balances at the central bank for settlement of claims within the banking system as these transactions are settled through the accounts of banks maintained with the central bank. Therefore, the daily functioning of a modern economy and its financial system creates a demand for central bank reserves which increases along with an expansion in overall economic activity (Friedman, 2000b).

2.5 CAPITAL MARKET IN INDIA: MEANING, FEATURES AND IMPORTANCE OF CAPITAL MARKET

The capital market is a market which deals in long-term loans. It supplies industry with fixed and working capital and finances medium-term and long-term borrowings of the central, state and local governments. The capital market deals in ordinary stock are shares and debentures of corporations, and bonds and securities of governments.

The funds which flow into the capital market come from individuals who have savings to invest, the merchant banks, the commercial banks and non-bank financial intermediaries, such as insurance companies, finance houses, unit trusts, investment trusts, venture capital, leasing finance, mutual funds, building societies, etc.

Further, there are the issuing houses which do not provide capital but underwrite the shares and debentures of companies and help in selling their new issues of shares and debentures. The demand for funds comes from joint stock companies for working and fixed capital assets and inventories and from local, state and central governments, improvement trusts, port trusts, etc. to finance a variety of expenditures and assets.

The capital market functions through the stock exchange market. A stock exchange is a market which facilitates buying and selling of shares, stocks, bonds, securities and debentures. It is not only a market for old securities and shares but also for new issues shares and securities. In fact, the capital market is related to the supply and demand for new capital, and the stock exchange facilitates such transactions.

Thus the capital market comprises the complex of institutions and mechanisms through which medium-term funds and long-term funds are pooled and made available to individuals, business and governments. It also encompasses the process by which securities already outstanding are transferred.

Importance or Functions of Capital Market:

The capital market plays an important role immobilizing saving and channel is in them into productive investments for the development of commerce and industry. As such, the capital market helps in capital formation and economic growth of the country. We discuss below the importance of capital market.

The capital market acts as an important link between savers and investors. The savers are lenders of funds while investors are borrowers of funds. The savers who do not spend all their income are called. “Surplus units” and the borrowers are known as “deficit units”. The capital market is the transmission mechanism between surplus units and deficit units. It is a conduit through which surplus units lend their surplus funds to deficit units.

Funds flow into the capital market from individuals and financial intermediaries which are absorbed by commerce, industry and government. It thus facilitates the movement of stream of capital to be used more productively and profitability to increases the national income.

Surplus units buy securities with their surplus funds and deficit units sells securities to raise the funds they need. Funds flow from lenders to borrowers either directly or indirectly through financial institutions such as banks, unit trusts, mutual funds, etc. The borrowers issue primary securities which are purchased by lenders either directly or indirectly through financial institutions.

The capital market prides incentives to savers in the form of interest or dividend and transfers funds to investors. Thus it leads to capital formation. In fact, the capital market provides a market mechanism for those who have savings and to those who need funds for productive investments. It diverts resources from wasteful and unproductive channels such as gold, jeweler, real estate, conspicuous consumption, etc. to productive investments.

A well-developed capital market comprising expert banking and non-banking intermediaries brings stability in the value of stocks and securities. It does so by providing capital to the needy at reasonable interest rates and helps in minimizing speculative activities.

The capital market encourages economic growth. The various institutions which operate in the capital market give quantities and qualitative direction to the flow of funds and bring rational allocation of resources. They do so by converting financial assets into productive physical assets. This leads to the development of commerce and industry through the private and public sector, thereby inducing economic growth.

In an underdeveloped country where capital is scarce, the absence of a developed capital market is a greater hindrance to capital formation and economic growth. Even though the people are poor, yet they do not have any inducements to save. Others who save, they invest their savings in wasteful and unproductive channels, such as gold, jewellery, real estate, conspicuous consumption, etc.

Such countries can induce people to save more by establishing banking and non-banking financial institutions for the existence of a developed capital market. Such a market can go a long way in providing a link between savers and investors, thereby leading to capital formation and economic growth

What are the main Features of a Capital Market?

It does not include the instruments or institutions which provide finance for short period (up to one year). The common instruments used in capital market are shares, debentures, bonds, mutual funds, public deposits etc.

Features

1. Link between Savers and Investment Opportunities:
   Capital market is a crucial link between saving and investment process. The capital market transfers money from savers to entrepreneurial borrowers.
2. Deals in Long Term Investment:
   Capital market provides funds for long and medium term. It does not deal with channelising saving for less than one year.
3. Utilises Intermediaries:
   Capital market makes use of different intermediaries such as brokers, underwriters, depositories etc. These intermediaries act as working organs of capital market and are very important elements of capital market.
4. Determinant of Capital Formation:

The activities of capital market determine the rate of capital formation in an economy. Capital market offers attractive opportunities to those who have surplus funds so that they invest more and more in capital market and are encouraged to save more for profitable opportunities.

5. Government Rules and Regulations:
   The capital market operates freely but under the guidance of government policies. These markets function within the framework of government rules and regulations, e.g., stock exchange works under the regulations of SEBI which is a government body.

Table 2.1 Capital Market and Money Market Difference on the basis of: participants, instruments traded, investment outlay and safety

Basis	CAPITAL MARKET	MONEY MARKET
Participants	Participants are financial institutions, banks, corporate entities, foreign investors and ordinary retail investors from the public	Participants are institutions such s RBI, Banks, Financial Institutions and finance companies
Instruments Traded	Equity shares, debentures, bonds, preference shares, etc	Treasury bills, trade bills, commercial papers, certificates of deposit
Investment outlay	Does not require huge investment outlay as value of units of securities is low	Requires huge investment outlay as instruments are quite expensive
Safety	Risky both in terms of returns and principal repayment	Safer with minimum risk of default
Duration	Deals in medium and long term securities	Deals in short term securities from 1 day up to 1 year
Liquidity	Low liquidity	High degree of liquidity
Expected returns	Generally yields high returns	Generally yields low returns

Table 2.2 Dist between: NSEI and OTCEI on the basis of:
size of company, securities traded, settlement, objective.

Basis	**NSE(I)**	**OTCE(I)**
Size of company	Paid up capital 3 crores & above	Paid up capital 30 lakhs and above
Securities traded	Trades in Equity, debentures, treasury bills, PSU, bonds, etc	Equity, debentures, etc
Settlement	Payment within *15* days of transaction	Payment within *7* days of the transaction
Objective	Nationwide, ringless transparent trading facility for both capital and money market	Serves as an exchange for securities of small companies

Distinguish between: Primary and Secondary Market on any 4 basis		
Basis	**Primary Market (*New Issue Market)***	**Secondary Market (*Stock Exchange)***
Securities trading	It is a market for new securities	It is a market for existing securities
Sale of securities	Securities are sold to investors directly by the company or through their intermediary	Securities are exchanged between investors without involvement of the company
Flow of funds	It directly promotes capital formation as flow of funds is from savers to investors	It indirectly promotes capital formation as it enhances liquidity of shares
Location	It has no fixed geographical location. Shares can be traded from anywhere	It has a fixed location and fixed working hours
Prices	Prices are determined by management of the company	Prices are determined by demand and supply of the securities

CH. 3

MONEY MARKET

Definition, Feature and Instruments

A market where short term funds are borrowed and lent is called 'money market'. It is a market for financial assets that are close substitutes for money. The instruments dealt with in the market are liquid and can be converted quickly into cash at low transaction cost.

As per RBI definitions "A market for short terms financial assets that are close substitute for money, facilitates the exchange of money in primary and secondary market".

According to the Reserve Bank of India "A money market is the centre for dealings, mainly of short term characters in money assets, it needs the short term requirements of borrowers and provide liquidity or cash to the lenders. It is a place where short term surplus investible funds at the disposal of financial institutions or individuals are bid by borrower's agents comprising institutions and individuals and also the government itself."

The money market is a mechanism that deals s with the lending and borrowing of short term funds (less than one year). It doesn't actually detain cash or money but deal s with substitute of cash like trade bills, promissory notes & Government papers which can convert into cash without any loss at low transaction cost.

It includes all individual, institution and intermediaries.

Features of Money Market

- It is a market purely for short-terms funds or financial assets called near money.
- The maximum period for which the funds are-traded in the market is one year
- No fixed place for carrying out operations
- The main organizations in the market are RBI, State governments, banks, corporate investors, etc.
- It deal s with financial assets having a maturity period less than one year only.

- In Money Market transaction cannot take place formal like stock exchange, only through oral communication, relevant document and written communication transaction can be done.
- Transaction has to be conducted without the help of brokers.
- It is not a single homogeneous market, it comprises of several submarket like cal money market, acceptance & bill market.
- The component of Money Market is the commercial banks, acceptance houses & NBFC (Non-banking f financial companies).

Instrument of Money Market: A variety of instrument is available in a developed money market. In India til1986, only a few instruments were available.

They were:

1) Treasury Bills (T-Bills)
   - Treasury bills (TBs), offer short-term investment opportunities, general ly up to one year.
   - They are thus useful in managing short-term liquidity.
   - Types of treasury bills through auctions
   - 91-Day, 182-day, 364-day, and 14-day TBs
2) Commercial paper (CP)
   - CP is a short term unsecured loan issued by a corporation typical ly financing day to day operation.
   - CP is very safe investment because the financial situation of a company can easily be predicted over a few months.
   - Only company with high credit rating issues CP's.
3) Certificates Of Deposit
   - Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialized form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institution for a specified time period

- Scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs)
- Select al l-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

4) Cal Money Market
   - Cal money market is that part of the national money market where the day to day surplus funds, mostly of banks are traded in.
   - They are highly liquid, their liquidity being exceed only by cash.
   - The loans made in this market are of the short term nature.

5) Commercial Bills Market
   - Funds for working capital required by commerce and industry are mainly provided by banks through cash credits, overdrafts, and purchase/discontinuing of commercial bills.

6) Bill Of Exchange
   - The financial instrument which is traded in the bill market of exchange. It is used for financing a transaction in goods that takes some time to complete.

3.1 MONEY MARKET INSTRUMENT

Money Market instruments mainly include Government securities, securities issued by private sector and banking institutions—

1. Government Securities
2. Money at Call and Short Notice
3. Bills Rediscounting
4. Inter-Bank Participation
5. Money Market Mutual Funds
6. Call Money Market and Short-term Deposit Market
7. Treasury Bills
8. Certificates of Deposits

9. Inter-Corporate Deposits
10. Commercial Bills
11. Commercial Paper
12. Gilt-edged (Government) Securities
13. Repo Market

1. ***Government Securities:*** The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills. The different types of Government Securities are—

Dated Securities	Zero Coupon Bonds	Partly Paid Stock	Floating Rate Bonds	Bonds with Call/Put Option	Capital Indexed Bonds
Issued at face value	Issued at discount to the face value	Issued at face value, but paid in installments over a period	Issued at face value	A bond issued at call and put option	Issued at face value
Interest or coupon rate is fixed at the time of issuance, and remains constant till redemption of the security	Do not carry any interest rate	Interest or coupon rate is fixed at the time of issuance, and remains constant till redemption of the security	Interest rate is fixed as a percentage over a predefined benchmark rate which may be Treasury bill, bank rate etc at the time of issuance	This bond is due for redemption in 2012 and carries a coupon of 6.72%	Interest rate is fixed as a percentage over the wholesale price index at the time of issuance.
The tenor of security is fixed	The tenor of security is fixed	The tenor of security is fixed	The tenor of security is fixed	This bond has been priced in line with 5 year bonds	The tenor of security is fixed

Dated Securities	Zero Coupon Bonds	Partly Paid Stock	Floating Rate Bonds	Bonds with Call/Put Option	Capital Indexed Bonds
The security is redeemed at par (face value) on its maturity date	The security is redeemed at par (face value) on its maturity date	The security is redeemed at par (face value) on its maturity date	The security is redeemed at par (face value) on its maturity date	This bond has been priced in line with 5 year bonds	The principal redemption is linked to the Wholesale Price Index.

The Government dated securities can be purchased for a minimum amount of Rs. 10,000/-and the Treasury bills of Rs. 25,000/-and in multiple thereof. The State Government Securities can be purchased for a minimum amount of Rs.1, 000/-.

2. ***Money at Call and Short Notice:*** Call money or call deposits are that money which is lent on condition to repay on call. Notice money refers to the money lent and repaid on a certain day's notice from the lenders. Banks borrow for a variety of reasons to maintain their cash reserve ratio, heavy payments, to maturity mismatch etc. Money at short notice is for a maturity upto 14 days. The main participants are banks and all India financial institutions as permitted by RBI.

   A minimum size of Rs. 20 crores for each transaction was permitting the participation of the corporate in the call money market. The Discount and Finance House of India (DFHI) enhanced the activity of Call Money Market and Short-term Deposit Market. It allows lending and borrowing of funds. The borrowers are essentially the banks. It can operate outside the purview of the provision of the ceiling rates fixed by the Indian Banks Association. The different participants that lend fund in the market are like GIC, IDBI, NABARD etc. The private Mutual funds were also participating in the market. The DFHI ascertains the settlement between the lender and the borrower about the availability of fund and the amount needed and the exchanges. It also provides advice regarding the interest rates applicable to them. Here, the call rates are more volatile as they are determined by the interaction of demand and supply of funds in the market which is based on the maintenance of Cash Reserve Ratio by the banks. There are two call rates maintained in India i.e. Inter-bank call rate and the lending rate of DFHI.

3. ***Bills Rediscounting Scheme:*** This is a money market scheme whereby banks may raise funds by issue of usance from issuing notes in convenient lots and maturities matching the genuine trade bills discounted by them. This instrument promotes liquidity in the market. Here the seller draws a bill of exchange and the buyer accepts it. Suppose, When X sells on credit and X (seller) needs money in the meantime, it may approach to the bank for discounting the bill and the seller gets the money. Now, the bank which has discounted the bill may require getting it 'rediscounted' with some other bank to get the fund. This is called 'bill rediscounting'. The bank has a facility to rediscount the bills with the RBI and other approved institutions like LIC, GIC, UTI, ICICI etc

4. ***Inter-Bank Participation Certificate:*** Inter-Bank Participation Certificates are instruments issued by scheduled commercial banks only to raise funds or to deploy short term surplus. This instrument is issued as per RBI guidelines for two purposes:
    1. on risk sharing basis
    2. Without risk sharing Inter-Bank Participation without risk sharing can have tenure of 90 days only where, the issuing bank as borrowing and the participating bank advances to the banks. In case of risk sharing basis, the lender bank shares losses with the borrowing banks by mutually determining the interest rate. The tenure may be for 90 to 180 days.

5. ***Money Market Mutual Funds (MMMFs):*** To provide safety, liquidity and return, MMMFs are formed which collect the small savings of a large number of savers and invest them in the capital market. This concept is extended to money market. Hence, the concept of money market mutual funds has coming up. The SEBI revises the guidelines on MMMFs from time to time relating to maximum limit of investment.

6. ***Treasury Bills:*** Treasury Bills are discounted securities issued at a discount face value as per the short term requirement of the Government of India. RBI issues Treasury Bills on a prefixed day and at a fixed amount. There are four types of Treasury Bills:
    1. 14-day T-bill maturity is in 14 days.
    2. 91-day T-bill maturity is in 91 days.
    3. 182-day T-bill maturity is in 182 days.
    4. 364-day T-bill maturity is in 354 days.

    These are highly liquid money market instruments. It is a zero default risk bearing paper. It helps in deployment of idle funds for very shorts periods as well.

7. ***Certificates of Deposits:*** These are issued according to the guidelines of the Reserve Bank of India in dematerialized form or Usance Promissory Note for the fund deposited at a bank or other financial institution. It is a negotiable money market instrument whose minimum deposit should be Rs.1 lakh and the multiples of Rs. 1 lkh thereafter. The maturity period of Certificates of Deposits should not be less than 15 days and not more than 1 year. But, it should not be less than 1 year and exceed 3 years for financial institution.

8. ***Inter-Corporate Deposits:*** Inter-Corporate Deposits are unsecured loan extended by one corporate to another. As the

cost of funds for a corporate is higher than a bank, the rates in this market are higher than those in the other market.

12. ***Repo Market:*** This money market instrument helps in collateralized short-term borrowing and lending through sale or purchase operation in debt instruments. Here the securities are sold by the holders to the investors with an agreement to repurchase them at a predetermined rate and date.

    On the other hand, under the reverse repo transactions, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date

9. ***Commercial Bills:*** These are the bills accepted by the buyer for goods and services on credit from the seller and which may be kept upto the due date and encased by the seller or may be endorsed to a third party. The bills being bills of exchange may be discounted with the banks or financial institutions. These bills may again be the rediscounted at the bank.

10. ***Commercial Papers (CP):*** It is an additional unsecured money market instrument to the investors as a source of short term borrowing. This instrument is issued in the form of a promissory note or dematerialized form. Every issuer has to appoint an Issuing and Paying Agent (IPA) for the issue of commercial papers and only a scheduled bank can act as an IPA for issuance of CP. The investor are given the Issuing and Paying Agent (IPA) certificate as well as issued physical certificates or arrangement is made for crediting the CP to the investor’s account with a depository. The CP issued for a maturity period between a minimum of 7 days and a maximum up to one year from the date of issue in the denomination of Rs. 5 lakh or multiples thereof. The main purposes of introducing CP are—

1. To enable the high level corporate borrowers such as leasing and financing of companies, manufacturing and financial institutions etc.
2. To diversify the sources of short term borrowing
3. To provide instrument for bank and financial institution in the money market.

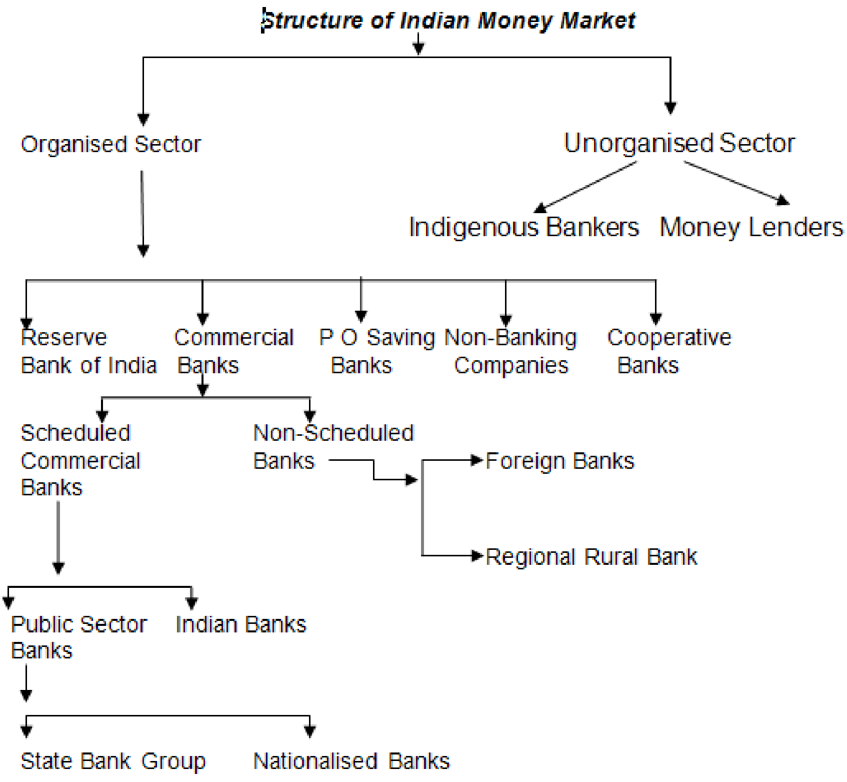
11. ***Gilt-edged (Government) Securities:*** Gilt-edged (Government) Securities have great demand by the banks to maintain the Net Demand and Time Liquidities (NDTL) position of the bank through its buying and selling. These securities are issued by Governments such as Central and State Governments, Semi-Government Authorities, Municipalities etc. They are long dated securities and held by the RBI. These issues are notified a few days before opening for subscription and offer is kept open for two to three days. The rate of interest is lower but it is payable half yearly.

12. ***Repo Market:*** This money market instrument helps in collateralized short-term borrowing and lending through sale or purchase operation in debt instruments. Here the securities are sold by the holders to the investors with an agreement to repurchase them at a predetermined rate and date.

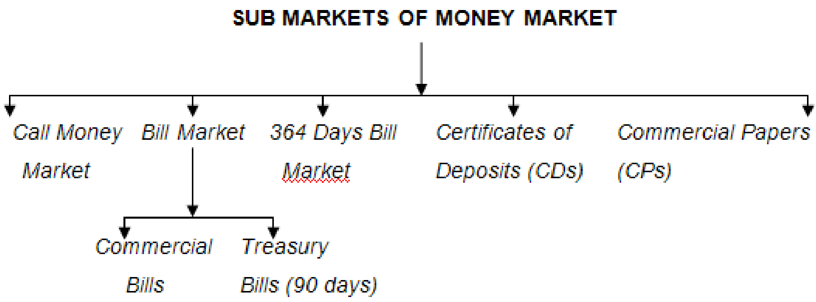
    On the other hand, under the reverse repo transactions, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date

3.2 STRUCTURE OF INDIAN MONEY MARKET

The Money Market is the close substitutes for money with the short term time span from overnight to year. The Indian Money Market consists of both organized and unorganized segment. The organized segment includes the Reserve Bank of India, State Bank of India, Public Sector as well as Private Sector Banks, Regional Rural Bank, Commercial Banks including Foreign Banks, Non-Scheduled Commercial Banks and other Non-Bank Financial Intermediaries such as LIC, GIC, and UTI etc. On the other hand, the unorganized segment consists of indigenous bankers, money lenders and other non-bank financial intermediaries.



Indian money market can be divided into various sub-markets depending on their nature and scope of the transactions and the features of the instruments.



3.3 MEASURES TO IMPROVE INDIAN MONEY MARKET

The major drawback of India Money Market is its high volatility. Gradually the money market transaction is increasing. But, on the recommendation of the Sukhmoy Chakravarty Committee (on the review of the working of the Monetary System) and the Narasimham committee (on the Report on the working of the financial system in India, 1991), RBI initiated a series of reform in Indian Money Market. The following are some of the measures undertaken,

1. ***Introducing new money market instrument:*** Many new money market instruments are introduced like Commercial Papers, Certificates of Deposits, 182-day Treasury, 364-day Treasury etc. The Discount and Finance House have also developed. These facilitate different short term borrowings to the different borrowers to collect fund as and when required to maintain their financial position.

2. ***Relaxation of interest rate regulations:*** The all types of interest rates like lending as well as deposit rates of the banks and financial institution are controlled and regulated by RBI. But, gradually the interest rates of the bank loans are controlled by the market forces which result decontrolled of it.

3. ***Remitting the stamp duties:*** In August 1989, Government remitted the stamp duty. But, it is not effective till it discourages the cash credit system in favour of using the bill system.

4. ***Sector specific refinance:*** Export credit refinance and general refinance are two refinance schemes that are in operation in the current financial system. The refinance is used by the central bank to control credit conditions and the liquidity positions in the system. But if the excessive funds supplies into the system do not result any the development then it could be highly distorted one.

5. ***Introduction of repo:*** This is used by the banks for short term liquidity through sale or purchase of debt instruments. It is an agreement to repurchase them at a predetermined rate and date between the RBI and commercial banks.

6. ***Introducing Money market Mutual Funds:*** The Money Market Mutual Funds were introduced in April 1991. The collection of the small savings invested generate short term avenues to the different investors.

7. ***Setting the Discount and Finance House in India:*** The DFHI equilibrated the surplus of fund and the deficit amounts of the banks. The DFHI helps in lending and borrowing of funds to the different banks as well as financial institutions.

3.4 CAPITAL MARKET

Meaning: It is the market for borrowing and lending long term capital required by business enterprises. The financial assets dealt with in the capital market have long or indefinite maturity period the capital market forms an important core of a country's financial system.

Definition

GH.Peters defines "Capital Market as being the market or collection of inter related markets in which potential borrowers are brought into contact with potential lenders."

Capital market deals in long term funds in both debt and equity with maturity ranging from 1 year to 10 years. It is a market where the productive capital is raised and made available for industrial purposes.

The capital market plays an important role in the financial system of a country by performing a number of functions.

1. Capital formation
2. An intermediary between the savers and investors
3. Mobility of capital
4. Economic development

Capital Market Instruments

Financial instruments that are used for raising capital resources in the capital market are known as capital market instruments, and they are as follows:

a. Preference shares
b. Equity shares
c. Non-voting Equity shares
d. Cumulative Convertible Preference shares
e. Company fixed deposits
f. Warrants
g. Debentures and bonds

Constituents of Indian capital market

1. The Gilt Edged Market
2. The Industrial Securities Market

1. **The Gilt Edged Market**: It is also known as the government securities market, which is a market for government' and semi government securities:

   Features of this market are as follows:

   a. Guaranteed return on investment
   b. No speculation on securities

c. Major institutions are LIC, PF and commercial banks
d. Heavy volume of transactions
e. Institutional based investors e.g: GP.Feli

2. **Industrial securities market**: It is the market for industrial securities such as bonds, equities, etc. It comprises of two segments-

   a. Primary Market

   b. Secondary Market

Primary market

It is also known as New Issue Market:

The market is utilized for raising fresh capital in the form of shares and debentures. The industrial sectors usually approach this market for raising fresh capital. It usually provides long term funds. The primary market is useful for capital formation in the country and accelerates economic and industrial development.

Mode of raising capital in the Primary market

A] **Public issue/Prospectus**: Securities are issued to the general public. This is the most popular method of raising long term fund. In this method securities are offered to the public by issuing prospectus.

B] **Right issue**: The equity shares of a company are issued to the existing equity shareholders in the form of right issue. In this issue additional securities are offered to the existing shareholders.

C] **Private placement**: Under private placement the shares of a company are sold among the selected group of persons.

There are three categories of participants in the primary market. They are the issuers of securities, investors and intermediaries.

Secondary market

It is a market where existing securities are sold or traded. This market is also known as stock market. The secondary market consists of recognized stock exchanges operating under rules, byelaws and regulations duly approved by the government.

A stock exchange is defined under the Section 2.(3) of the Securities Contracts (Regulations) Act 1956 as "An association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating or controlling of business in buying, selling or dealing in securities."

Functions of Secondary Market

1. To facilitate liquidity and marketability of securities
2. To contribute to economic growth through mobilization of funds to the most efficient channels
3. To provide instant valuation of securities dealt in on stock exchange
4. To ensure a measure of safety and fair dealing to protect investors interest

Visit the stock exchange and observe how buying and selling of securities takes place.

Distinction between: Primary market and Secondary market .

Points	Primary Market	Secondary Market
Meaning	The market is utilized for raising fresh capital in the form of shares and debentures.	It is a market where existing securities are resold or traded.
Function	The function is to raise long term funds through fresh issue of securities	The function is to provide continuous and ready market for existing long term securities

Points	Primary Market	Secondary Market
Participants	The participants are financial institutions, mutual fund, under writer, individual investor	The participants of primary market as well as the stock brokers and the members of the stock exchange are the participants.
Listing requirements	Listing is not required in the case of primary market	Only listed securities can be dealt in the secondary market
Determinants of prices	The prices are determined by the management of the corporate houses with due compliances with the SEBI requirements for new issue of securities	In case of secondary market the prices are determined by forces of demand and supply in the market and they keep on fluctuating

Distinction between: Money market and Capital market:

Points	Primary Market	Secondary Market
Meaning	A market where short term funds are borrowed and lend	A market for borrowing and lending long term capital required by business enterprises
Terms of Finance	It provides short term funds, in short terms instruments where the maturity is measured in days, weeks or months.	It is a market for long term instruments which is measured in years.
Instruments	The instruments dealt in the market are bills of exchange, treasury bills, bankers acceptance, etc.	The instruments dealt in this market are bonds, debentures, equity shares and stock.
Functions	Money market exists as a mechanism of liquidity adjustment i.e. a link between the depositors and borrowers.	Capital market functions as a link between the investors and interpreneurs.
Risk	The prices of these instruments do not fluctuate and they carry very low market risk.	The instruments are long term and subject to market fluctuations and so they carry very high financial and market risk.
Institution	The commercial banks are the important institutions in the money market.	The stock exchange is an important institution in the capital market.

The financial market consists of two major segments

a) Money market
b) Capital market.

Money market is a market for short-term funds which deals in financial assets whose period of maturing is up to one year. The credit instruments in this market are bill of exchange, commercial bills, treasury bills, etc.

Capital market deals in medium and long term funds. It contributes two markets i.e. Gilt edged market and securities market.

The securities market consists of two different segments i.e. Primary market and secondary market. Primary market only deals in the issue of new securities.

Secondary market consists of stock exchanges, a market for purchase and sale of existing securities.

The instruments in the capital market are preference shares, equity shares, Company fixed deposits etc.

Merchant banking

Meaning: The term 'merchant banking' has been used differently in different parts of the world. While in U.K. merchant banking refers to the 'accepting and issuing houses', in U.S.A. it is known as 'investment banking'. The word merchant banking has been so widely used that sometimes it is applied to banks who are not merchants, sometimes to merchants who are not banks and sometimes to those intermediaries who are neither merchants not banks.

In India merchant banking services were started only in 1967 by National Grindlays Bank followed by Citi Bank in 1970. The State Bank of India was the first Indian Commercial Bank having set up separate Merchant Banking Division in 1972. In India merchant banks have been primarily operating as issue houses than full-fledged merchant banks as in other countries.

A merchant bank may be defined as an institution or an organization which provides a number of services including management of securities issues, portfolio services, underwriting of capital issues, insurance, credit syndication, financial advices, project counseling etc. There is a distinction between a commercial bank and a merchant bank. The merchant banks mainly offer financial services for a fee. While commercial banks accept deposits and grant loans. The merchant banks do not act as repositories for savings of the individual s.

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. It helps to expand and modernize the business. It helps in restructuring of a business. It helps to revive sick business units. It al so helps companies to register, buy and sell shares at the stock exchange

In short, merchant banking provides a wide range of services for starting until running a business. It acts as Financial Engineer for a business.

Functions of Merchant Banks: The basic function of a merchant banker is marketing corporate and other securities. Now they are required to take up some al lied functions al so.

A merchant bank now takes up the following functions:

1. **Promotional Activities:** A merchant bank functions as a promoter of industrial enterprises in India He helps the entrepreneur in conceiving an idea, identification of projects, preparing feasibility reports, obtaining Government approval s and incentives, etc. Some of the merchant banks al so provide assistance for technical and financial collaborations and joint ventures

2. **Issue Management:** In the past, the function of a merchant banker had been mainly confined to the management of new public issues of corporate securities by the newly formed companies, existing companies (further issues) and the foreign companies in dilution of equity as required under FERA In this capacity the merchant banks usual ly act as sponsor of issues.

   They obtain consent of the Control ller of Capital issues (now, the Securities and Exchange Board of India) and provide a number of other services to ensure success in the marketing of securities. The services provided by them include, the preparation of the prospectus, underwriting arrangements, appointment of registrars, brokers and bankers to the issue, advertising and arranging publicity and compliance of listing requirements of the stock-exchanges, etc.

   They act as experts of the type, timing and terms of issues of corporate securities and make them acceptable for the investors on the one hand and al so provide flexibility and freedom to the issuing companies.

3. **Credit Syndication:** Merchant banks provide specialized services in preparation of project, loan applications for rising short-term as well aslong-term credit from various bank and financial institutions, etc. They al so manage Euro-issues and help in raising funds abroad.

4. **Portfolio Management:** Merchant banks offer services not only to the companies issuing the securities but al so to the investors. They advise their clients, mostly institutional investors, regarding investment decisions. Merchant bankers even undertake the function of purchase and sal e of securities for their clients so as to provide them portfolio management services. Some merchant bankers are operating Mutual funds and off shore funds al so.

5. **Leasing and Finance:** Many merchant bankers provide leasing and finance facilities to their customers. Some of them even

maintain venture capital funds to assist the entrepreneurs. They al so help companies in raising finance by way of public deposits.

6. **Servicing of Issues:** Merchant banks have al so started to act as paying agents for the service of debt-securities and to act as registrars and transfer agents. Thus, they maintain even the registers of shareholders and debenture holders and arrange to pay dividend or interest due to them

7. **Other Specialized Services:** In addition to the basic activities involving marketing of securities, merchant banks al so provide corporate advisory services on issues like mergers and amalgamations, tax matters, recruitment of executives and cost and management audit, etc. Many merchant bankers have al so started making of bought out deal s of shares and debentures. The activities of the merchant bankers are increasing with the change in the money market

The important functions of merchant banking are depicted below.

1. **Raising Finance for Clients:** Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.

2. **Broker in Stock Exchange:** Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They al so advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.

3. **Project Management:** Merchant bankers help their clients in the many ways. For e.g. advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.
4. **Advice on Expansion and Modernization:** Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up-gradation, etc.
5. **Managing Public Issue of Companies:** Merchant bank advice and manage the public issue of companies. They provide following services:
   a. Advise on the timing of the public issue.
   b. Advise on the size and price of the issue.
   c. Acting as manager to the issue, and helping in accepting applications and al lotment of securities.
   d. Help in appointing underwriters and brokers to the issue.
   e. Listing of shares on the stock exchange, etc.
6. **Handling Government Consent for Industrial Projects:** A businessman has to get government permission for starting of the project. Similarly, a company requires permission for expansion or modernization activities. For this, many formal ities have to be completed. Merchant banks do all this work for their clients.
7. **Special Assistance to Small Companies and Entrepreneurs:** Merchant banks advise smal companies about business opportunities, government policies, incentives and concessions available. It all so helps them to take advantage of these opportunities, concessions, etc.
8. **Services to Public Sector Units:** Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign

collaborations and arranging long-term finance from term lending institutions.

9. **Revival of Sick Industrial Units:** Merchant banks help to revive (cure) sick Industrial Units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It all so plans and executes the full revival package.

10. **Portfolio Management: A** merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.

11. **Corporate Restructuring:** It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer al these services to their clients.

12. **Money Market Operation:** Merchant bankers deal with and underwrite short-term money market instruments, such as:
    a. Government Bonds.
    b. Certificate of deposit issued by banks and financial institutions.
    c. Commercial paper issued by large corporate firms.
    d. Treasury bills issued by the Government (Here in India by RBI).

13. **Leasing Services:** Merchant bankers al so help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor al lows the use of his specific asset such as equipment by the lessee for a certain period. The lessor charges a fee called rental s.

14. **Management of Interest and Dividend:** Merchant bankers help their clients in the management of interest on debentures/loans,

and dividend on shares. They al so advise their client about the timing (interim/yearly) and rate of dividend

3.5 INDUSTRIAL DEVELOPMENTBANK OF INDIA (IDBI)

IDBI stands for Industrial Development Bank of India. It was founded with the objective of financing and help develop small and medium scale industries in India.

IDBI was set up in July 1964 under an Act of Parliament as a wholly-owned subsidiary of Reserve Bank of India.

In 1976 its ownership had been transferred to Government of India. After the transfer of its ownership, IDBI became the main institution, through which the institutes engaged in financing, promoting and developing industry were to be coordinated. International Finance Division of IDBI transferred to Export-Import Bank of India, established as a wholly-owned corporation of Government of India, under an Act of Parliament in the year 1982.

In January 1992, IDBI accessed domestic retail debt market for the first time, with innovative Deep Discount Bonds, and registered path-breaking success. The following year, it set up the IDBI Capital market Services Ltd., as its wholly-owned subsidiary, to offer a broad range of financia services, including Bond Trading, Equity Broaking, Client Asset Management and Depository Services.

In September 1994, in response to RBI's policy of opening up domestic banking sector to private participation, IDBI set up IDBI Bank Ltd., in association with SIDBI.

In July 1995, public issue of the bank was taken out, after which the Government's shareholding came down (though it still retains majority of the shareholding in the bank).

In September 2003, IDBI took over Tata Home Finance Ltd, renamed 'IDBI Home finance Limited', thus diversifying its business domain and entering the arena of retaifinance sector.

The year 2005 witnessed the merger of IDBI Bank with the Industrial DevelopmentBank of India Ltd. The new entity continued to its development finance role, while providing an array of wholesale and retail banking products (and does so till date). The following year, IDBI Bank acquired United Western Bank (which, at that time, had 230 branches spread over 47 districts, in 9 states). In the financial year of 2008, IDBI Bank had a net income of Rs 9415.9 crores and total assets of Rs120,601 crores

A. Subsidiaries

The following are the subsidiaries of IDBI.

1. Small Industries Development Bank of India (SIDBI)
2. IDBI Bank Ltd.
3. IDBI Capital market Services Ltd.
4. IDBI Investment Management Company

B. Objectives and Functions of IDBI

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

1. Co-ordination, regulation and supervision of the working of other Financial Institutions such as IFCI, ICICI, UTI, LIC, Commercial Banks and SFCs.
2. Supplementing the resources of other Financial Institutions and there by widening the scope of their assistance.
3. Planning, promotion and development of key industries and diversification of industrial growth.
4. Devising and enforcing a system of industrial growth that conforms to national priorities.

Functions: The IDBI has been established to perform the following functions-

1. 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.
2. 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
3. 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 concern s for exports.
4. To discount or re-discount bills of industrial concern s.
5. To underwrite or to subscribe to shares or debentures of industrial concern s.
6. To subscribe to or purchase stock, shares, bonds and debentures of other financial institutions.
7. To grant line of credit or loans and advances to other Financial Institutions such as IFCI, SFCs, etc.
8. To grant loans to any industrial concern.
9. To guarantee deferred payment due from any industrial concern.
10. To guarantee loans raised by industrial concern s in the market or from institutions.
11. To provide consultancy and merchant banking services in or outside India.
12. To provide technical, legal, marketing and administrative assistance to any industrial concern or person for promotion, management or expansion of any industry.
13. Planning, promoting and developing industries to fillup gaps in the industrial structure in India.
14. To act as trustee for the holders of debentures or other securities.

C. Reserve Bank of India (RBI)

The central bank of the country is the Reserve Bank of India (RBI). It was established in Apri1935 with a share capital of Rs. 5 crores on the basis of the recommendations of the Hilton Young Commission. The share capital was divided into shares of Rs. 100 each fully paid which was entirely owned by private shareholders in the beginning. The Government held shares of nomina value of Rs. 2,20,000.

Reserve Bank of India was national isued in the year 1949. The generasuperintendence and direction of the Bank is entrusted to Central Board of Directors of 20 members, the Governor and four Deputy Governors, one Government official from the Ministry of Finance, ten nominated Directors by the Government to give representation to important elements in the economic life of the country, and four nominated Directors by the Central Government to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. LocaBoards consist of five members each Central Government appointed for a term of four years to represent territorial and economic interests and the interests of co-operative and indigenous banks.

The Reserve Bank of India Act, 1934 was commenced on Apri1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank.

The Bank was constituted for the need of following:

1. To regulate the issue of banknotes
2. To maintain reserves with a view to securing monetary stability and
3. To operate the credit and currency system of the country to its advantage.

D. Role of Reserve Bank of India (RBI): As a central bank, the Reserve Bank has significant powers and duties to perform. For smooth and speedy progress of the Indian Financial System, it has to perform some important tasks. Among others it includes maintaining monetary and financial stability, to develop and maintain stable payment system, to promote and develop financial infrastructure and to regulate or control the financial institutions.

1. **Issuer of currency:** Except for issuing one rupee notes and coins, RBI is the sole authority for the issue of currency in India. The Indian government issues one rupee notes and coins. Major currency is in the form of RBI notes, such as notes in the denominations of two, five, ten, twenty, fifty, one hundred, five hundred, and one thousand. Earlier, notes of higher denominations were al so issued. But these notes were demonetized to discourage users from indulging in black-market operations. **RBI** has two departments-the Issue department and Banking department. The issue department is dedicated to issuing currency. Al the currency issued is the monetary liability of RBI that is backed by assets of equal value held by this department. Assets consist of gold, coin, bullion, foreign securities, rupee coins, and the government's rupee securities. The department acquires these assets whenever required by issuing currency. The conditions governing the composition of these assets determine the nature of the currency standard that prevails in India. **The** Banking department of RBI looks after the banking operations. It takes care of the currency in circulation and its withdraw from circulation. Issuing new currency is known as expansion of currency and withdraw of currency is known as contraction of currency.

2. **Banker to the Government:** RBI acts as banker, both to the central government and state governments. It manages

all the banking transactions of the government involving the receipt and payment of money. In addition, RBI remits exchange and performs other banking operati**on**s. RBI provides short-term credit to the central government. Such credit helps the government to meet any shortfall ls in its receipts over its disbursements. RBI al so provides short term credit to state governments as **advances. RBI** al so manages all new issues of government loans, servicing the government debt outstanding, and nurturing the market for government's securities. RBI advises the government on banking and financial subjects, international finance, financing of five-year plans, mobilizing resources, and banking legislation.

3. **Managing Government Securities:** Various Financial Institutions such as commercial banks are required by law to invest specified minimum proportions of their total assets/ liabilities in government securities. RBI administers these investments of institutions.

4. **Th**e other responsibilities of RBI regarding these securities are to ensure-
   a) Smooth functioning of the market
   b) Readily available to potential buyers
   c) Easily available in large numbers
   d) Undisturbed maturity-structure of interest rates because of excess or deficit supply
   e) Not subject to quick and huge fluctuations
   f) Reasonable liquidity of investments
   g) Good reception of the new issues of government loans

5. **Banker to Other Banks:** The role of RBI as a banker to other banks is as follows:
   a) Holds some of the cash reserves of banks
   b) Lends funds for short period
   c) Provides central sized clearing and quick remittance facilities

RBI has the authority to statutorily ensure that the scheduled commercial banks deposit a stipulated ratio of their total net liabilities. This ratio is known as cash reserve ratio [CRR] r, banks can use these deposits to meet their temporary requirements for interbank clearing as the maintenance of CRR is calculated based on the average balance over a period.

6. **Controller of Money Supply and Credit:** In a planned economy, the central bank plays an important role in controlling the paper currency system and inflationary tendency. RBI has to regulate the claims of competing banks on money supply and credit. RBI al so needs to meet the credit requirements of the rest of the banking system.

   RBI needs to ensure promotion of maximum output, and maintain price stability and a high rate of economic growth. To perform these functions effectively, RBI uses several control instruments such as-
   a) Open Market Operations
   b) Changes in statutory reserve requirements for banks
   c) Lending policies towards banks
   d) Control over interest rate structure
   e) Statutory liquidity ration of banks

7. **Exchange Manager and Controller:** RBI manages exchange control l, and represents India as a member of the international Monetary Fund [IMF]. Exchange control was first imposed on India in September 1939 when World War II started and continues till date. Exchange control was imposed on both receipts and payments of foreign exchange.

   According to foreign exchange regulations, al foreign exchange receipts, whether on account of export earnings, investment earnings, or capital receipts, whether of private or government accounts, must be sold to RBI either directly or through authorized dealers. Most commercial banks are authorized dealers of RBI.

8. **Publisher of Monetary Data and Other Data:** RBI maintains and provides all essential banking and other economic data, formulating and critically evaluating the economic policies in India. In order to perform this function, RBI collects, collates and publishes data regularly. Users can avail this data in the weekly statements, the RBI monthly bulletin, annual report on currency and finance, and other periodic publications.

E. Developmental and Promotional role of RBI: Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.

1) **Development of the Financial System**: The financial system comprises the financial institutions, financial markets and financial instrument s. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

2) **Development of Agriculture:** In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and al lied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the

credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

3) **Provision of Industrial Finance**: Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special Financial Institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

4) **Provisions of Trainning:** The RBI has all ways tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

5) **Collection of Data**: Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful lfor researchers and policy makers.

6) **Publication of the Reports**: The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public al so at cheaper rates.

7) **Promotion of Banking Habits**: As an apex organization, the RBI al ways tries to promote the banking habits in the country. It institutional sizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962,

UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

8) **Promotion of Export through Refinance**: The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

Mutual Fund

A Mutual fund is a professionally managed type of collective investment scheme that pools money from any investors and invests it in stocks, bonds, short-term money market instruments and other securities. Mutual funds have a fund manager who invests the money on behalf of the investors by buying/selling stocks, bonds etc. The income earned through these investments and the capital appreciations realized are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. The flow chart below describes broadly the working of a mutual fund:

WHO MANAGES INVESTOR’S MONEY? This is the role of the Asset Management Company (the Third tier). Trustees appoint the Asset management Company (AMC), to manage investor’s money. The AMC in return charges a fee for the services provided and this fee is borne by the investors as it is deducted from the money collected from them. The AMC’s Board of Directors must have at least 50% of Directors who are independent directors.

THE ROLE OF THE AMC: The role of the AMC is to manage investor's money on a day to day basis. Thus it is imperative that people with the highest integrity are involved with this activity. The AMC cannot deal with a single broker beyond a certain limit of transactions. The AMC cannot act as a Trustee for some other Mutual Fund. The responsibility of preparing the OD lies with the AMC. Appointments of intermediaries like independent financial advisors (IFAs), national and region distributors, banks, etc. is al so done by the AMC. Finally, it is the AMC which is responsible for the acts of its employees and service providers.

3.6 ADVANTAGES OF MUTUAL FUNDS: The advantages of investing in a Mutual funds are:

1) Professional Management
2) Diversification
3) Convenient Administration
4) Return Potential
5) Low Costs
6) Liquidity
7) Transparency
8) Flexibility
9) Choice of schemes
10) Tax benefits
11) Well regulated

Role and Function NABARD (National Bank for Rural l & Agriculture Development)

NABARD is set up as an apex Development Bank with a mandate for facilitating credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts. It al so has the mandate to support al other al lied economic activities in Rural areas, promote integrated and sustainable Rural development and secure prosperity of Rural areas.

NABARD was established on the recommendations of Shivaraman Committee, by an act of Parliament on 12 July 1982 to implement the NationsBank for Agriculture and Rural Development Act 1981. It replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cel(RPCC) of Reserve Bank of India, and Agricultural Refinance and Development Corporation (ARDC). It is one of the premier agencies to provide credit in Rural areas.RBI sold its stake in NABARD to the Government of India, which now holds 99% stake.

Mission

1) Promoting sustainable and equitable agriculture and Rural development through effective credit support, related services, institution building and other innovative initiatives.
2) In pursuing this mission, NABARD focuses its activities on:
3) Credit functions, involving preparation of potential-linked credit plans annual ly for al districts of the country for identification of credit potential, monitoring the flow of ground level Rural credit, issuing policy and operational guidelines to Rural financing institutions and providing credit facilities to eligible institutions under various programmers
4) Development functions, concerning reinforcement of the credit functions and making credit more productive
5) Supervisory functions, ensuring the proper functioning of cooperative banks and regional Rural banks

Role and Function of NABARD: In discharging its role as a facilitator for Rural prosperity NABARD is entrusted with

- Providing refinance to lending institutions in Rural areas
- Bringing about or promoting institutional development and
- Evaluating, monitoring and inspecting the client banks

Besides this pivot role, NABARD al so:

- Acts as a coordinator in the operations of Rural credit institutions
- Extends assistance to the government, the Reserve Bank of India and other organizations in matters relating to Rural development
- Offers training and research facilities for banks, cooperatives and organizations working in the field of Rural development
- Helps the state governments in reaching their targets of providing assistance to eligible institutions in agriculture and Rural development
- Acts as regulator for cooperative banks and RRBs

Microfinance and NABARD: For a better reach of microfinance program a continuous check of the status, progress, trends, qual itative and quantitative performance comprehensively is required. Thus the Reserve Bank of INDIA and NABARD has laid out certain guidelines in 06-07 for the commercial banks, RegionaRural Banks and Cooperative Banks to provide the data to RBI and NABARD about the progress of the microfinance program. There are three aspects on which the data was collected, savings of self-help groups with banks, loan disbursed by banks to self-help groups default by self-help group's repayment of the loans taken from banks. Banks al so provides data regarding loans given by banks to the microfinance institutions.

3.7 INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI)

The Industrial Credit and Investment Corporation of India Limited (ICICI) incorporated at the initiative of the World Bank, the Government of India and representatives of Indian industry, with the objective of creating a development financial institution for providing medium-term and long-term project financing to Indian businesses.

ICICI emerges as the major source of foreign currency loans to Indian industry. Besides funding from the World Bank and other multi-lateraagencies, ICICI was al so among the first Indian companies to raise funds from international markets.

ICICI Bank was established in 1994 by the Industrial Credit and Investment Corporation of India, an Indian financial institution, as a wholly owned subsidiary. The parent company was formed in 1955 as a joint-venture of the World Bank, India's public-sector banks and public-sector insurance companies to provide project financing to Indian industry. The bank was initial ly known as the Industrial Credit and Investment Corporation of India Bank, before it changed its name to the abbreviated ICICI Bank. The parent company was later merged into ICICI Bank.

History of ICICI

1955:

The Industrial Credit and Investment Corporation of India Limited (ICICI) incorporated at the initiative of the World Bank, the Government of India and representatives of Indian industry, with the objective of creating a development financial institution for providing medium-term and long-term project financing to Indian businesses. Mr.A.Ramaswami Mudal iar elected as the first Chairman of ICICI Limited.

ICICI emerges as the major source of foreign currency loans to Indian industry. Besides funding from the World Bank and other multi-lateral agencies, ICICI was al so among the first Indian companies to raise funds from international markets.

1967:

ICICI made its first debenture issue for Rs.6 crore, which was oversubscribed.

1977:

ICICI sponsored the formation of Housing Development Finance Corporation. Managed its first equity public issue

1982:

ICICI became the first ever Indian borrower to raise European Currency Units. ICICI commences leasing business

1986

ICICI became the first Indian institution to receive ADB Loans.

ICICI, along with UTI, set up Credit Rating Information Services of India Limited, India's first professional credit rating agency.

ICICI promotes Shipping Credit and Investment Company of India Limited.

1994:

ICICI Bank was established in 1994 by the Industrial Credit and Investment Corporation of India, an Indian financial institution, as a wholly owned subsidiary.

ICICI Securities and Finance Company Limited in joint venture with J. P. Morgan set up.

1996:

ICICI Asset Management Company set up.

ICICI Bank set up.

ICICI Ltd became the first company in the Indian financial sector to raise GDR.

1998:

ICICI Banking Corporation Ltd, the first bank in the country to go in for Internet banking, is now al set to provide its account-holders with the facility of transferring funds across their accounts on the Net.

2000:

ICICI Bank became the first Indian bank to list on the New York Stock Exchange with its $175-million American depository shares issue generating a demand book 13 times its size at $2.2 billion.

2001:

The Boards of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly owned retail finance subsidiaries, ICICI Personal Financial services Limited and ICICI Capital Services Limited, with ICICI Bank. The merger was approved by shareholders of ICICI and ICICI Bank in January 2002, by the High Court of Gujarat at Ahmadabad in March 2002, and by the High Court of Judicature at Mumbai and the Reserve Bank of India in Apri2002.

2008:

Following the 2008 financial crisis, customers rushed to ATM's and branches in some locations due to rumors of adverse financial position of ICICI Bank. The Reserve Bank of India issued a clarification on the financial strength of ICICI Bank to dispute rumors.

2010:

ICICI Bank opens first retail branch in Singapore.

RBI approves the amalgamation of Bank of Rajasthan Ltd with ICICI Bank Ltd.

2012:

ICICI Bank opens its second branch in Hong Kong.

ICICI Bank was the first private sector bank in India to offer PPF account facility at al bank branches.

Export-Import Bank of India: Objectives and Functions

The Export-Import Bank of India was set up by the Government of India on January 1, 1982. Its main objects are:

1. To ensure and integrated and co-ordinate approach in solving the al lied problems encountered by exporters in India.
2. To pay specific attention to the exports of capital goods;
3. Export projection;
4. To facilitate and encourage joint ventures and export of technical services and international and merchant banking;
5. To extend buyers' credit and lines of credit;
6. To tap domestic and foreign markets for resources for undertaking development and financial activities in the export sector.

The functions of EXIM Bank include:

a) Planning, promoting and developing exports and imports;
b) Providing technical, administrative and managerial assistance for promotion, management and expansion of export sector.
c) (c) Undertaking market and investment surveys and techno-economic studies related to development of exports of goods and services.

The Exim Bank has a 17-member Board of Directors, with Chairman and Managing Director as the chief executive and full-time director. The Board of Directors consists of the representative of the Government of India, RBI, IDBI, ECGC, commercial banks and the exporting community.

The authorized capital of Exim Bank is Rs. 200 crores, of which Rs. 75 crores is paid up. The banks have secured a long-term loan of Rs. 20 crores from the Government of India. It can al so borrow from the RBI. It is empowered to raise resources in domestic and international markets.

The Bank began its lending operations from March, 1982. TilJune, 1982, it has extended assistance up to Rs. 133 crores to the export sector in various ways.

The establishment of Exim Bank may be regarded as a right step in the export promotion policy and programmme of the Government.

During 1984, the Exim Bank sanctioned various programmes of funded assistance of Rs. 430 crores. It al so launched a new programme to provide term finance for export-oriented units, under which assistance was provided through a consortium for establishing a 100 per cent export unit in the ceramics industry.

The Exim Bank al so extended its financial assistance to Indian exports through letters of credit, re-lending facility, export bills rediscounting, overseas investment finance, facilities for deemed exports and assistance to hundred per cent export units and units in free trade zone.

At the end of December 1984, the Exim Bank’s outstanding underfunded and non-funded assistance amounted to Rs. 415 crores and Rs. 510 crores, respectively.

In 1984, the Exim Bank signed a loan agreement to borrow one billion yen from the Japanese commercial yen market.

In June 1986, the Exim Bank introduced a new programme called the Export Marketing Fund (EMF), under which finance is made available to Indian companies for undertaking export marketing activities. The programm al so covers activities like desk research, minor product adaptation, overseas operations and trave to India by buyers overseas. During 1986, Rs. 78 lakhs were sanctioned, while Rs. 3.4 lakhs have been utilised under the EMF.

On whole, the Exim Bank concluded an agency credit line of US $ 15 million with the International Finance Corporation (IFC).

During 1994-95, Exim Bank sanctioned Rs. 2,466 core and disbursed Rs. 2,130 crore of financial assistance under various lending project

Industrial Finance Corporation of India: Functions, Management and Activities of the IFCI

Industrial Finance Corporation of India: Functions, Management and Activities of the IFCI

Government of India set up the Industrial Finance Corporation of India (IFCI) in July 1948 under a special Act. This is the first financial institution set up in India with the main object of making medium and long term credit to industrial needs.

The Industrial Development Bank of India, Schedule banks, insurance companies, investment trusts and co-operative banks are the shareholders of IFCI. The Union Government has guaranteed the repayment of capital and the payment of a minimum annual dividend.

The corporation is authorized to issue bonds and debentures in the open market, to borrow foreign currency from the World Bank and other organizations, accept deposits from the public and al so borrow from the Reserve Bank.

The authorized share capital of the IFCI was Rs. 10 crore at the initial stage, According to the Industrial Finance Corporation (Amendment) Act, 1986, the authorized capital of the corporation has been raised from Rs. 100 crore to Rs. 250 crore (the authorized capital may be fixed by the government of India by notification from time to time).

Objective of IFCI

1. To provide long and medium-term credit to industrial concern s engaged in manufacturing, mining, shipping and electricity generation and distribution.

2. The period of credit can be as long as 25 years and should not exceed that period;
3. 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;
4. guarantee loans and deferred payments;
5. underwrite and directly subscribe to shares and debentures issued by companies;
6. assist in setting up new projects as well as in modernization of existing industrial concern s in medium and large scale sector;
7. Assist projects under co-operatives and in backward areas.

The functions of the IFCI base as follows:

1. The corporation grants loans and advances to industrial concern s.
2. Granting of loans both in rupees and foreign currencies.
3. The corporation underwrites the issue of stocks, bonds, shares etc.
4. The corporation can grant loans only to public limited companies and co-operatives but not to private limited companies or partnership firms.

Functions: The main functions of I.F.C.I. are as under:-

1. Granting loans and advances for the establishment, expansion, diversification and modernization of industries in corporate and co-operative sectors.
2. Guaranteeing loans raised by industrial concern s in the Capital Market, both in rupees and foreign currencies.
3. Subscribing or underwriting the issue of shares and debentures by industries. Such investment can be held up to 7 years.
4. Guaranteeing credit purchase of capital goods, imported as well as purchased within the country.

5. Providing assistance, under the soft loans scheme, to selected industries such as cement, cotton textiles, jute, engineering goods, etc.
6. Providing technical, legal, marketing and administrative assistance to any industrial concern for the promotion, management and expansion of the industrial concern .
7. Providing equipment (imported or indigenous) to the existing industrial concern s on lease under its 'equipment leasing scheme'.
8. Procuring and reselling equipment to eligible existing industrial concern s in corporate or co-operative sectors.
9. Rendering merchant banking services to industrial concern s.

Organization and Management:

The Head Office of the IFCI is in New Delhi. It has al so established its Regional offices in Bombay, Chennai, Kolkata, Chandigarh, Hyderabad, Kanpur and Guwahati. The branch office of IFCI is located in Bhopal, Pune, Jaipur, Cochin, Bhubaneswar, Patna, Ahmedabad and Bangal ore.

The IFCI is managed by a Board of Directors, headed by a Chairman, who is appointed by the Government of India, in consultation with RBI. The chairman holds his position for a period of 3 years, subject to extension.

Of the 12 directors, 4 are nominated by the IDBI, three of whom are experts in the fields of industry, labour and economics and the fourth is the General Manager of the IDBI. The remaining 8 directors are nominated.

Two directors are nominated for a term of 4 years by each of the following-scheduled banks, co-operative banks, insurance companies and investment companies making up eight directors.

The promotional activities of IFCI are explained below:

1. **Soft Loan Assistance:** This scheme provides soft loan assistance to existing industries in small and medium sector for developing technology through in-house research and development.
2. **Entrepreneur Development:** IFCI provides financial support to EDPs (Entrepreneur Development Programmes) conducted by several agencies al l-over India. In co-operation with Entrepreneurship Development Institute of India.
3. **Industrial Development in Backward Areas:** IFCI al so take measures to promote Industrial Development in backward areas through a scheme of concessional finance.
4. **Subsidized Consultancy:** The IFCI gives subsidized consultancy for,
   a. Small Entrepreneurs for Meeting the Cost of Project.
   b. Promoting Ancillary Industries
   c. To do the Market Research.
   d. Reviving Sick Units.
   e. Implementing Modernization.
   f. Controlling Pollution in Factories.
5. **Management Development:** To improve the professional management the IFCI sponsored the Management Development Institute in 1973. It established the Development Banking Centre to develop managerial, manpower in industrial concern, commercial and development banks.

Working of the IFCI:

The working of the IFCI came in for a large measure of criticism. In the first place, the rate of interest which the corporation charged was extremely high. Secondly, there was a great delay in sanctioning loans and in making the amount of the loans available.

Thirdly, the 'corporation's insistence on the personal guarantee of managing directors in addition to the mortgage of property was considered wrong In the last two decades the corporation had entered into new lines of activity, viz, underwriting debentures and shares and guaranteeing of deferred payment in respect of imports from abroad of plant an equipment by industrial concern s and subscribing to stocks and shares of industrial concern s directly Besides, the performance of IFCI together with the work of other public sector Financial Institutions has been extremely credit worthy in the last two decades.

State Financial Corporation's (SFCs)
Objectives and Functions

IFCI was established to cater to the financial needs of industrial concern s in large scale corporate and co-operative sectors. Small and medium sized enterprises were outside the purview of IFCI. To meet the financial needs of small and medium enterprises, the government of India passed the State Financial Corporation Act in 1951, empowering the State governments to establish development banks for their respective regions.

Under the Act, SFCs have been established by State governments to meet the financial requirements of medium and small sized enterprises. There are 18 SFCs at present.

Objectives

The objectives of state financial corporations are as under:

1. Provide financial assistance to small and medium industrial concern s. These may be from corporate or co-operative sectors as in case of IFCI or may be partnership, individual joint hindu family business. Under SFCs Act, "industrial concern " means any concern engaged not only in the manufacture, preservation or processing of goods, but al so mining, hotel industry, transport undertakings, generation or distribution of electricity, repairs and maintenance of machinery, setting up or development of an industrial area or industrial estate, etc.

2. Provide long and medium-term loan repayable ordinarily within a period not exceeding 20 years.

3. Grant financial assistance to any single industrial concern under corporate or co-operative sector with an aggregate upper limit of rupees Sixty lakhs. In any other case (partnership, sole proprietorship or joint hindu family) the upper limit is rupees Thirty lakhs.

4. Provide Financial assistance general ly to those industrial concern s whose paid up share capital and free reserves do not exceed Rs. 3 crore.

5. To lay special emphasis on the development of backward areas and small scale industries.

Functions of State Financial Corporation (SFCs)
The functions of SFCs include

1. Grant of loans and advances to or subscribe to debentures of, industrial concern s repayable within a period not exceeding 20 years, with option of conversion into shares or stock of the industrial concern.
2. Guaranteeing loans raised by industrial concern s which are repayable within a period not exceeding 20 years.
3. Guaranteeing deferred payments due from an industrial concern for purchase of capital goods in India.
4. Underwriting of the issue of stock, shares, bonds or debentures by industrial concern s.
5. Subscribing to, or purchasing of, the stock, shares, bonds or debentures of an industrial concern subject to a maximum of 30 percent of the subscribed capital, or 30 percent of paid up share capital and free reserve, whichever is less.
6. Act as agent of the Central government, State government, IDBI, IFCI or any other financial institution in the matter of grant of loan or business of IDBI, IFCI or financial institution.

7. Providing technical and administrative assistance to any industrial concern or any person for the promotion, management or expansion of any industry.
8. Planning and assisting in the promotion and development of industries

3.8 ORGANIZED MONEY MARKET

The organised money market can be further segmented into two categories:

1. Market for Banking Financial Institutions

Under this the entire banking network is administered by RBI, which has the following many more classification viz Public sector banks, Scheduled banks, Private sector bank, Co-operative banks, Regional Rural l banks and Land development banks

2. Market for Non Banking Financial Institutions

The non banking financial institutions are nothing but development banks, state financial institutions. The money market is further divided into various segments viz Bills market, Discounting market, Acceptance market, Marketable securities market, Gilt edged securities market and so on

1. ***Bill market:*** In this market only, the bills are bought and sold among the players. It is the market for both commerce bill and finance bill. The commerce bill is nothing but the bill of exchange defined in accordance with the Sec. 5 of the Negotiable Instruments Act. It arises only due to credit sales among the parties, only in order to safeguard the interest of the suppliers who supplied the goods and articles on credit.
2. ***Discounting market:*** It is another most important market for discounting of the bills of the trade. These are normal

ly carried out by the banking and financial institutions in addition to Discounting Housing Finance of India which is the apex body for rediscounting in India next to Reserve Bank of India. The bills are discounted by the banking and a non banking financial institution only on the basis of the credibility of the parties involved in the bilwho has accepted to make the payment on the maturity of the bill.

3. ***Acceptance market:*** In India, there is no separate acceptance market for accepting the bills before discounting, but in U.K., there is greater scope for accepting the bill before the process of discounting. Normal ly, the discounting is carried out only on the basis of the extent of acceptance given by the acceptance houses on the bills produced.

4. ***Govt Securities market:*** The govt securities are al so tradable in the secondary market immediately after the issuance. According to the Public debt act, the central and state govt are empowered to issue the securities to raise financial resources from the public for developmental aspects of the state or region. The treasury bills are mainly traded in the market immediately after the issuance The following are the major type of treasury bills traded in the market are 91 days treasury bills, 182 days treasury bill and 364 days treasury bill

5. ***Bonds market:*** It is a separate market available to raise the financial resources through long term debt instrument. The bonds are normal ly issued by the corporate sectors and govt organizations. They are many in categories viz Secured and unsecured bonds Pay in kind bonds Redeemable bonds and irredeemable bonds and so on.

3.9 UN-ORGANIZED MONEY MARKET

This particular market is dominated by the pawn brokers, chit funds, nidhis, and so on.

There are no stringent guidelines prevailing to control and monitor the role of the above mentioned players.

In addition to the above classifications, one more classification is that of insurance companies which are separately governed by the IRDA which has got its own segments as following:

- Life insurance sector
- Non life insurance sector
- Pension funds
- Heal th insurance and so on

CH. 4

CAPITAL MARKET

The nature of Capital Market

It is a market where all organizations, Financial Institutions and instruments provide long and medium term funds to the business sector.

The two major components of Capital market are

- Primary (new issue market)
- Secondary market (stock exchange).

The nature of Capital market can be understood from the following points:

- It acts a link between savers and borrowers who need funds to invest profitably and efficiently.
- It helps firms to procure finances for long-term investments such as buying plant & machinery, building, etc.
- It obtains its funds through issue of various securities such as equity shares, bonds, debentures and innovative securities like zero interest bonds and deep discount bonds.
- It functions thru’ various intermediaries such as underwriters, bankers, stock brokers, etc.
- It includes both individual investors and institutional investors such as UTI, LIC, IDBI, etc

State any four PROTECTIVE functions of SEBI?

- It prohibits ***insider trading.*** It prevents insiders such as directors, promoters who have access to price sensitive information regarding securities of the company (which is not available to the public) to make individual profits through trading of securities.
- It prohibits ***fraudulent and unfair trade practices*** in the security market like making misleading statements and price rigging. (Manipulating with the sole intention of inflating or deflating the market price of securities is termed as “price rigging)
- It promotes ***fair practices and code of conduct*** in the securities market.

Example: Looks after the interest of the debenture holders in terms of any midterm revision of interest rate, etc.

- It takes steps to ***educate investors.***

SEBI is a REGULATORY authority of the securities market.

- It carries out audit of the share markets
- It regulates takeover of companies
- It regulates the business being conducted in the share market.
- It registers and regulates the working of brokers, sub brokers, transfer agents, merchant banks, underwriters, etc.
- It registers and regulate the credit rating agency, venture capital funds and Mutual Funds

Developmental functions of SEBI

- It promotes trading of intermediaries of the securities market.
- It adopts a flexible approach to develop the Capital Market.

4.1 REFORMS IN PRIMARY MARKET

A reform in Capital market includes:

- Merchant banking and banking code installed
- Due diligence certificate from the lead managers
- Disclosure norms
- Companies details-facts and risk factors associated with their projects
- Stock exchanges required to ensure the formal cities with the companies during the issues
- Restriction in the usage of Stock invest-institutional investors
- Disclosure norms for the advertisement
- Underwriting is optional and if it is not carried out due to bring down the issue cost–90% of the amount offered to the public-should be refunded
- Bonus guidelines were relaxed
- New system introduced for preferential issue-pertaining to pricing

- Shri Y H Malegam–disclosure requirements and issue procedures
- SEBI to vet the prospectus within 21 days from the date of issue and approval by the registrar companies is given a time period of 14 days
- Abridged prospectus-should be vetted by the SEBI

Reforms in the Primary Market: 1996-97

- Norms were tightened-to enhance the quality of the paper
- First time issuers-dividend payment record in three of the immediately preceding five years
- If this requirement is not applicable in the case of companies–appraisal should be done through commercial banks or financial institutions-10% contribution from the issuer out of the total size of the issue
- For banks-no restriction but if the issues are premium priced-two years profitability record
- Prohibition on direct or indirect discounts during the moment of allotment
- 90% of the subscription waived due to minimum share holding
- Housing finance companies allowed to function as registered issue facilitating companies in along with the refinancing from the National housing bank
- The promoters contribution should be in a phased manner if it crosses Rs.100 cr
- Debt securities could be listed in the stock exchanges without any listing of equity shares.

Reforms in 1997-98

- Entry for unlisted companies modified
- Partly paid up shares should be either fully converted or forfeit
- 3 Years profitability required for the unlisted companies for the issuance of share capital
- For rights issue-Registrar should be separately deputed
- Details of the promoters should be given in the offer document

- Only body corporates allowed to function as merchant bankers
- Merchant bank classifications abolished
- Merchant banks are not permitted to carry out the fund related activities; if any corporates are available-suitable breathing time was given to restructure the activities

Reforms in 1998-2001

- Entry norms revised
- Pre issue net worth should not be less than 1 cr in 3 preceding years out of 5
- Merchant banks registered with RBI as NBFCs eligible to trade Govt securities
- permitted to derivatives
- Further updating was made in the companies act to protect the investors
- Additional power granted to SEBI for the violation of the companies act
- SEBI compendium 2000 issued
- On line offerings were encouraged by SEBI
- Regulation of rating agencies framed
- ESOP guidelines
- Changes introduced on Mutual funds the P.K.Kaucommittee
- Issue freedom is given to companies but not less than Re 1
- 100% book building route introduced

4.2 REFORMS IN THE SECONDARY MARKET

- Guidelines with reference to substantial takeovers and acquisitions-disclosures
- Guidelines with regards to mandatory public offer to the investors
- Sever mutual funds were al lowed
- UTI brought under the SEBI
- Advertising code was initiated as well as the requirements of pre-vetting of advertisement removed

- To improve the role of the Mutual funds as well as to develop the market of mutual fund in India, Mutual funds were given-right to underwrite the public issues and to make investments in the money market
- Jumbo transfer was introduced for the institutions
- Carry forward system of transactions are permitted to SEs after getting the consent and surveillance
- Carry forward transactions are limited in the case of lenders of the transactions
- Carry forward transactions should be disclosed on the basis of scrip and broker at the beginning of carry forward session
- Capital adequacy norms were introduced
- Depositories were introduced during the year 1995 Sept.; to record the ownership
- in the book form
- The introduction of depository requires the changes in the following enactments
  1. Companies Act
  2. Stamp Duty Act
  3. Income Tax Act

Capital market Reforms: 1996-97

- Depositories Act 1996-promulgated in order to reduce the problems associated
- with the handling of securities
- Guidelines for the custodian of securities were clearly drafted
- Custodian of securities-compliance officer should be appointed-to bridge the gap in between
- Changes are expected to discuss during the monthly meetings of Association of
- Custodian of security services
- Bad delivery cell was set up and code was specified

- System of clearing house or clearance corporation to be set up in the stock exchange
- Separate committee has been set up for surveillance-inter stock exchange transactions
- Mumbai and other stock exchanges were allowed to install terminal s-where no exchange exists-to have on line trading
- Norms of the OTCEI were eased to promote more transactions

Capital market Reforms: 1997-98

- Daily carry forward margin reduced to 10% from 15%
- Over al carry forward increased to Rs.20 crs per broker

Capital market Reforms: 1998-2001

- Buy back of securities were permitted
- Circuit breaker system was introduced to control volatility
- Dematerialized trading was initial ised
- Rolling settlement introduced
- Internet trading was introduced
- Guidelines were issued in the angle of maintaining the transparency
- Clause 49-to maintain corporate governance introduced
- Stock watch system was introduced
- Steps introduced to reduce the transaction costs
- Trading of stock index and futures-BSE and NSE commenced
- For trading of debt securities-to promote debt market-steps taken

Capital market Reforms: 2005-2007

- Golden pegged return funds permitted
- IPO norms are tightened
- Grading of IPOs are suggested

4.3 SEBI IN CAPITAL MARKET ISSUES

Introduction

During the late 80, the GOI decided to replace the Control ller of Capital Issues Act, by way of inducting the Securities Exchange Board of India, in order to introduce the regulatory environment in the Indian capital market, to pave way for the promotion of congenial and conducive climatic condition for the investing public. Hence the Government of India has instituted the supreme authority SEBI to monitor and control the proceedings of the capital market in the country.

4.4 OBJECTIVES OF THE SEBI

1. Control of Capital Issues Act (1947)
2. The Companies Act (1956)-issue, allotment of the securities and disclosures
3. Securities contract regulation Act (1956)-to control over the stock exchanges
4. In May, 1992-the controller of issue of capital, pricing of the issues, fixing premier and rates of debentures were ceased in operation, provided the SEBI was promulgated.
5. Protecting the interest of the investors
6. Promoting the development of the securities market
7. Regulating the securities market

4.5 ORGANISATIONAL GRID OF THE SEBI

1. Six members in the committee
2. Headed by the chairman
3. One member each from the ministries of Law and Finance
4. One member from the official s of Reserve Bank of India
5. Two nominees from the central government
6. It contains 4 different departments viz Primary department, Issue management and

7. intermediaries department, Secondary department and Institutional Investment department

4.6 POWERS AND FUNCTIONS OF SEBI

Section 11 of the Act Chapter IV highlights the Powers and Functions of SEBI

1. Regulating the business of the stock exchanges
2. Regulating the role of the intermediaries
3. Registering and regulating of depositories, participants and custodian of securities, credit rating agencies
4. Regulating of mutual funds and venture capital funds
5. Prohibiting the unfair trade practices
6. Prohibiting of insider trade activities
7. Regulating substantial takeovers and acquisitions
8. Frequent conduct of research activities
9. To conduct any enquiry which warrants the situation to safeguard the interest of the investors

   Civil Court Procedure 1908: The SEBI has been given additional powers and function with reference to Civil Court Procedure 1908 to regulate the capital market in addition to the above enlisted powers and functions

10. Discovery and production of books of account of the errant during the inspection and enquiry.
11. Summoning and enforcing the attendance of the persons to stand before for the examination of oath.

4.7 ROLE OF SEBI

Entry norm for the companies at the moment of raising the capital from the market:

- The companies are expected to produce 3 years dividend track record of preceding the issue.

- At the entry level, immediately after listing, important point to be ensured is that Post issue of net worth should be 5 times greater than the Pre issue net worth.
- If it is a manufacturing company without any track record, wants to raise any capital from the market, the appraisal has to be done through development banks or commercial l banks.
- Having three years track record, the SEBI never vets offer document of the issue of capital.

1. Promoter's Contribution

a. Promoter's contribution should not be less than 20% and should be made before the issue.
b. If the size of the issues is Rs. 100 cr-50% of the contribution should be made before the opening of issue and the remaining should be paid before the cal ls are made to the investors.

2. Disclosures

a. Acc. Bhave committee-Financial results i.e., unaudited and audited financial results should be published.
b. Risk factors and positions of the company should be highlighted in detail in the prospectus.

3. Book Building

a. 75% route was specified at the early moment in the process of book building. Then the book building process was opened to 100% route to the public.
b. Sufficient opportunities are to be furnished to the investors to represent through the terminal to take part in the process of Book building.
c. The company during the process requires 30 centres at least for book building process to raise the share capital from the market.

4. Al location of Shares

a. The Minimum application was-100 Nos for subscribing the issue of share capital then the Minimum application was hiked to 500 Nos. Then SEBI has felt that the Minimum application was too high, which did not pave the small investors to within the available surplus, and then the minimum application brought down to 200 Nos.
b. Small investors are who hold 1000 shares or few securities
c. Allotment should be done within 30 days from the date of closure of the issue. During the non allotment of the shares, the company should refund the amount of the application money.

5. Market Intermediaries

a. The various merchant bank categories were abolished.
b. Each category of issue intermediary is required to undergo for specific registration process.
c. Lead managers who manage the issue of capital should have a net worth of Rs.5 cr.

6. Debt Market Segment

a. Depository system for the debt securities were introduced
b. Demat facility was specifically introduced for the government securities
c. Listing of debt securities need not rely upon the equity listing in the respective stock exchange
d. FIIs were permitted to invest 100% in the debt instruments of the Indian companies
e. For the issuance of debt instruments the rating has been mandatory
f. Minimum two ratings should be obtained for the issue of debt instrument more than Rs. 500 cr.
g. Rating agency should not be associated with the firm of issuing company

7. Brokers

a. Registration is given-Member of any stock exchange-key factors of registration-office space, previous experience, man power, selling or buying in securities
b. Code of conduct-execution of orders, fairness of deal s with the investors, issue of contract note Financial statements-should be submitted within 6 months of the accounting period Book of accounts-A minimum of 5 years to be preserved Regional offices-Establishment only with reference to attend the complaints of the small investors at speedy rate-Kolkata, Chennai and Delhi SEBI's final controlling measure is suspension and cancellation of the registration subject to certain conditions

8. Suspension of a Broker

a. Suspension-permanent-dismissal is leading to cancellation of registration-due to the problem caused
b. Violation of rules and regulations
c. Fails to submit the true and fair information according to the norms of disclosures
d. Untoward conduct with the investor
e. Guilty of misconduct
f. Poor financial status of the brokers-deterioration
g. Stock exchange fees-faito pay on time to the requirement
h. Suspension of the membership
i. Indulges in any act of insider trading of securities
j. Convicted of a any criminal offence
k. Sub-Broker Sub-broker-to obtain the registration
l. Agreement in between broker & sub-broker
m. Deposit should be made with–Broker
n. Transfer of securities-without registration of bearing stamps-considered as bad deliveries in the angle of stock exchanges-July 1, 1997.

9. Recent Developments

a. RBI approval copy is exempted
b. FIIs are permitted to invest upto 100% in debt market funds
c. FIIs which have securities worth of Rs 100 cr or more than mandatory requirement is to settle the transaction only through demat mode
d. FIIs/NRIs/OCB-30% of the equity of the company in accordance with the union budget-1997-98
e. It was hiked by the Union Finance Minister during the budget 2000

4.8 ORGANISED CAPITAL MARKET

The capital market which was initial ly controlled and organized by the Controller of Capital Issues act and then it was replaced by the Securities Exchange Board of India for the governance of capital market in India. The capital market in India is known as regulated in spheres by SEBI then and there. The organised capital market is bifurcated into two categories viz Primary market and Secondary market.

1. ***Primary market:*** It is the market for the fresh issuance of securities by the new as well as existing companies, in order to raise the capital from the investors. The Primary market is further classified into many segments
2. ***Initial Public offering:*** As a new company registered under the Companies Act 1956 is permitted to raise the capital from the market through the abridged prospectus.
3. ***Public issue:*** It is another mode of raising the capital from the common public by the existing companies.
4. ***Private placement:*** During the issue, the larger investment houses are invited for the subscription of the issue of securities in bulk quantities at a discount price prior to the issue. After the issue, according to the investment policy of the Institutional

investors, they sell them at higher price to the individual investors. This facilitates the institutional investors to book profits through the process of private placement.

5. ***Underwriting:*** It is another mode of issuing the securities during the issue, more particularly this mode of issue is found to be an avenue to off-load the risk of managing the issue of securities as well asto secures the issue as fully subscribed.
6. ***Secondary market:*** It is the market for the securities which are already available in the market, to buy and sell among the players. This is the market further classified into two different categories viz mutualisation and demutualisation of stock exchanges.
7. ***Mutualised Stock exchanges:*** These are the exchanges never have any distinction among the members, management and governing body of the stock exchange. These are purely administered by the members/brokers of the stock exchange, e.g.,. Traditional stock exchanges.
8. ***Demutualised stock exchanges:*** These are separate distinct faces among themselves. The roles and responsibilities of the brokers, governing body members and people in the management are clearly defined and performed by them without any ambiguity e.g. OTCEI, NSE and so on.

4.9 UN-ORGANIZED CAPITAL MARKET

Due to stringent guidelines of SEBI, unofficial market trading activities are banned only in order to safeguard the interest of the investors. Kerb trading which was taken place among the players of the stock market during the nonworking hours of the stock exchange. This trading is known in other words as unofficial trading or black trading among the players. The next segment is nothing but the money market which controlled and monitored by the Reserve Bank of India.

CH. 5

FEE BASED FINANCIAL SERVICES

Fee Based Financial Services

INTRODUCTION: With the change in the complex business environment, financial services play a pivotal role in facilitating the smooth flow of the entire financial system. Financial services include:

(A) Venture Capital Financing
(B) Factoring & Forfeiting
(C) Leasing
(D) Underwriting
(E) Credit Rating Agencies
(F) Others

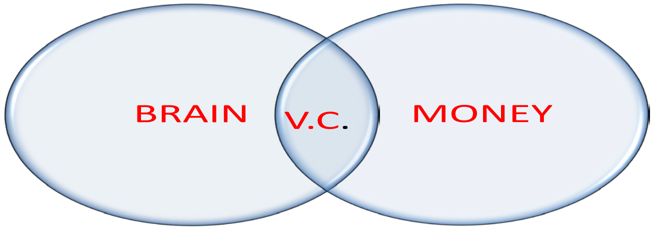
5.1. VENTURE CAPITAL FINANCING

The term venture capital comprises of two words that is, "Venture" and "Capital". Venture is a course of processing, the outcome of which is uncertain but to which is attended the risk or danger of "loss". "Capital" means recourses to start an enterprise. To connote the risk and adventure of such a fund, the generic name Venture Capital was coined

Venture capital is defined as long-term funds in equity or semi-equity form to finance hi-tech projects involving high risk and yet having strong potential of high profitability.

1.1 Definition of Venture capital:-

"The support by investors of entrepreneurial talent with finance and business skills to exploit market opportunities and thus obtain capital gains



1.2. Features of venture capital

1. Investments are made in innovative projects with new technology with a view to commercialize the know how through new products/services.
2. The claim over the management is decided on the basis of proportion to investments.
3. Venture capital investors closely watch the performance of the business unit.
4. Venture capital funds are realized through the stock exchange.

1.3. Venture capital investment process

1. **Establishment of contact between the entrepreneur and the venture capitalist:** The entrepreneur with his know-how prepares a project report establishing there in the possibility of marketing a commercial product
2. **Preliminary evaluation:** After the preliminary evaluation of the report, the venture capital investor discusses the investment plan with the banker.
3. **Detailed approval:** Techno-economic feasibility will be examined by involving the executives of the VCI & mgmt professional.
4. **Sensitivity analysis:** The forecasted results of both sales and profits are tested and analyzed. The risks and threats are evaluated, which helps the probable risks and returns associated with the project.
5. **Investment in the project:** The terms and conditions of venture capital assistance are finalized according to the requirement of the project.
6. **Monitoring the project and post investment support:** The venture capital investor closely watches the performance of the business unit.

1.4. Stages of venture capital financing

1.0.1. **Early stage financing:** This stage of financing is done to initiate the new project or help the new technocrat who wishes to commercialize his research talents. Going for debt in this stage increases the risk of the entrepreneur and affects the health of the business unit. He has to depend mainly on equity stock so that the risk of repayment doesn't arise.

i) **Seed capital:** It includes implementation of the research project, starting from the all initial stage.
   (a) The technology used in the project and possible threats of new technology in the near future.
   (b) Different aspects of the product life cycle.
   (c) The total investment required to commercialize the product and time required to get the suitable return.

ii) **Start-up stage financing:** The innovator requires finance to commercialize the product. Patent rights, trade marks, design and copyrights are very essential to launch the product effectively.

iii) **Second round of financing:** It is required when the project incures loss or shows inability to sufficient profits. It may be due to internal or external factors.

The original investor may express the inability to further finance the project or entrepreneur must have lost the confidence with the original investor or he may wish to broad base the investment pattern.

1.0.2. **Later stage financing:** The product launched has not only reached the boom period but also indicates further expansion and growth.

i) **Mezzanine/development capital:** The business have overcome the extremely high-risk early stage, have recorded profits for a few years, go for public issue and raise money

ii) **Bridge/expansion:** Expand business by way of growth of their own productive asset or by acquisition

iii) **Buyouts:**

(a) **Management buyouts:** They are provisions of funds to enable existing management/investors to acquire an existing product

(b) **Management buy-ins:** They are funds provided to enable an outside group buy an ongoing venture

iv) **Turnarounds/rescue capital:** This means of financing is risky and the investor may ask for major changes in the management.

1.5. Valuation methods of venture financing: It is a method of VCUs which take into account only the starting time of investment and the exit time

1. The present annual revenue in the beginning is compounded by an expected annual growth for the holding period, for computing annual revenue at the time of liquidation
2. The expected earnings level is equal to future earnings level multiplied by after tax margin percentage
3. The future market valuation is equal to earnings level multiplied by expected
P/E ratio
4. The present value is obtained by using discount factor.

1.5.1. The first Chicago method: It is a method of valuation that considers the entire earnings stream of the VCU/ VCI companies

1. 3 alternative scenarios are considered–success, sideways survival and failure
2. Using discount rate, discounted present value of the VCU is computed.

3. Discounted present value is multiplied by respective probabilities.

   Expected present value of the VCU is equal to the 3 scenarios

1.5.2. Revenue multiplier method

M_t = V/R

= $\mathbf{(1+r)^n * a * p/(1+d)^n}$

V = Present value of VCU

R = annual revenue level

r = expected annual rate of growth of revenue

n = expected no: of yrs from the starting date to exit date (holding period)

a = expected after-tax profit margin % at the time of exit

p = expected price/earning ratio at exit time

d = appropriate discount rate for a venture investment

1.6. Methods of Venture Financing

1. Equity
2. Conditional Loan
3. Income Note
4. Other Financing Methods
   (a) Participating Debentures
   (b) Partially Convertible Debentures
   (c) Cumulative Convertible Preference Shares
   (d) Deferred Shares
   (e) Convertible Loan Stock
   (f) Special Ordinary Shares
   (g) Preferred Ordinary Shares

5.2. FACTORING

Factoring is an arrangement in which a financial intermediary called as "factor" which collects the accounts receivables on behalf of the goods and services. The factor charges a fee that is usually expressed as a percentage of the total value of the receivables factored.

FORFAITING: The term **"a forfeit"** in French means, **"relinquish a right".** It refers to the exporter relinquishing his right to a receivable due at a future date in exchange for immediate cash payment, at an agreed discount, passing all risks and responsibilities for collecting the debt to the forfeiter.

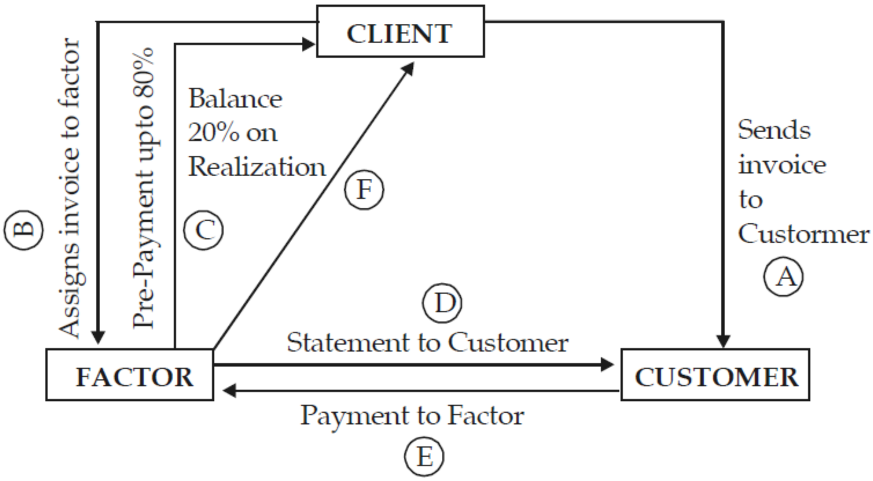
It is the discounting of international trade receivable on a 100% "Without recourse" basis. "Without recourse "means the client gets full credit protection and all the components of service, i.e., short-term finance, administration of sales ledger are available to the client.

Forfeiting transforms the supplier's credit granted to the importer into cash transaction for the exporter protecting him completely from all the risks associated with selling overseas on credit. It effectively transforms a credit sale into a cash sale.

Factors are usually subsidiaries of banks or private financial companies, generally, render the following services:

a) purchasing the accounts receivable of the seller for immediate cash;
b) administering the sales ledger of the seller;
c) collects the accounts receivable;
d) forecasts the losses which may arise due to bad debts;
e) Advisory services to the seller.

Factoring is an alternative to in-house management of receivables.



2.1. How Factoring works

(a) Seller raises the bill on the customer and issues a notification that the invoice is assigned to and must be paid to the factor.

(b) Copies of invoice sent to the factor

(c) Factor will provide pre-payment of up to a maximum of 80% of the total invoice value

(d) Follow up procedure with the customers for realization of payments due

(e) Balance payment is made on realization of dues

(f) Seller will be informed of factor invoices through monthly statement of account sent by the factor.

2.2. Types of Factoring

(a) **Recourse factoring:** the factor purchases the receivables on the condition that any loss arising out of irrecoverable debts will be borne by the seller/client.

(b) **Non-recourse or full factoring**: the client gets full protection and all the components of service.

(c) **Advance factoring or maturity factoring**: no advance or prepayment is made by the factor. The payment is made to the client either on a guaranteed payment date or on the date of collection from the customer.

(d) **Invoice discounting**: the factor provides a prepayment to the client against the purchase of account receivables and collects interest (Service charges) for the period extending from the date of prepayment to the date of collection. The administration and collection charges shall be borne by the client.

(e) **Undisclosed factoring:** companies of a very high repute and sound financial base can opt for this type of factoring. Here, the client's customers are not notified of the factoring agreement and they continue to make to the client. The client bears the responsibility of making payment to the Factor on the due date, irrespective of realizations from the customers.

2.3 Factoring is not advisable in the following situations

(a) Where sales are made for cash;

(b) In case of speculative business;

(c) For highly specialized capital equipments or goods made-to-order;

(d) If the credit period is more than 180 days;

(e) In case of "consignment sale" or "sale or return arrangements";

(f) Sales to associated companies;

(g) Sales are made to public at large.

2.4 Factoring Vs. Forfeiting

Factoring	Factoring
1. 80% of the invoice value is considered for advance	1. 80% of the invoice value is considered for advance
2. Factor does the credit rating of the counterparty in case of non-recourse factoring	2. Factor does the credit rating of the counterparty in case of non-recourse factoring
3. Day to day administration of sales and other allied services are provided	3. Day to day administration of sales and other allied services are provided
4. Advances are generally short-term in nature	4. Advances are generally short-term in nature

5.3. LEASING:

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. It may be defined as:

(a) A contractual agreement between the lessor (owner of an asset/ equipment) and the lessee (the user of such asset/equipment);

(b) Which provides a right to the user of the asset, over a certain agreed period of time?

(c) Against a consideration, lease rentals.

3.1 Definition

The Transfer of Property Act defines a lease as a transaction in which a party owning the asset provides the asset for use over a certain period of time to another for consideration either in the form of periodic rent and/or in the form of down payment.

Lease may also be defined as a contract between two parties for the hire of a specific asset wherein the lessor retains ownership of the asset while the lessee has possession and use of the asset on payment of a specified rental over a period of time.

Leasing is suitable for financing the investments in productive equipments and is available to a broad range of business and other service organizations like: hospitals, educational institutions, associations and government as well as nongovernment agencies.

3.2 Parties to Lease agreements:

3.2.1 Lessee

Lessees vary widely from the one-person operations to the Fortune Hundred corporations where diverse equipments are being leased. Transactions range from a few thousands worth of equipment (such as fax machines) to crores worth cogeneration facilities, telecommunications systems, medical equipment (including CAT scanners and MRI imaging), office systems, computers, commercial aircraft, and transportation fleets. There is no end to the types of equipments that companies lease.

3.2.1.1. Obligations of Lessee

The rights and obligations of a lessee in a lease contract are many and varied.

Some of them are:

- To use the assets during the lease period in accordance to the terms and conditions of the lease agreement.
- To put to proper use, operation, maintenance and storage of the equipment under lease.
- To remit periodically the lease rentals as per the lease agreement.
- To insure at all times and for an amount equal to the full insurable value of the asset.
- To return to the lessor the leased asset on the expiration or earlier termination of the Lease agreement, i.e., in the event of default by the lessee

3.2.2 Lessor

Lessor in most cases, are corporate only. There are four basic types of such companies:

- Banks or bank-affiliated firms;
- Captive leasing companies such as subsidiaries of equipment manufacturers who lease out their parent's products;
- Independent leasing companies, which may be small and specialized or large and diversified;
- Others, including those investment bankers and independent brokers/packagers who bring the parties of a lease together;

3.2.2.1Rights and Obligations of Lessor

The rights and obligations of a lessor in a lease contract are;

- Right of ownership of the leased asset.
- Right to claim depreciation on the asset.
- Right to ensure that the asset is put to fair use and within the limitations contained in the agreement.
- Right to collect the rentals and other sums payable by the lessee under agreement.
- Right to sue in case of breach of agreement or any acts of the lessee which ultra vires the agreement.

3.3. Types of Lease

The following are the different types of Lease agreements.

1. **Operating lease:** Here the lease period is shorter than the expected useful life of the equipment. Rental payments do not cover the equipment cost of the lessor during the initial lease term. This type of lease is popular for high-tech equipment, because shorter term leases help equipment users stay ahead of equipment obsolescence. The lessor uses its equipment with remarketing expertise

to subsequently find other users for the returned equipment, something the typical equipment user does not have time or ability to do.

2. **Finance lease:** Here the lease period is longer, more nearly covering the useful life of the equipment. Rentals tend to be lower because of the longer term and less residual value risk.

3. **Sale-leaseback:** One who purchases the equipment has the need and uses it for a period of time before selling it to a lessor. After selling the equipment, one then lease the equipment. This is another way to free up ones operating capital. On smaller equipment leases worth thousands of rupees, leases tend to be more standardized. Above that cost range-several hundred thousand into the millions-variations appear more frequently.

4. **Leveraged lease:** Under this lease, bigger acquisitions are made, such as acquiring an airplane. This may include several customized provisions and options that would not appear in a typical lease for a smaller amount, thus leading to flexibility in the product size of the lease.

5. **Short Term Lease:** These leases are typically for assets that have high depreciation eligibility like computers, windmills etc. They are for a period of 2-3 years, and may be useful to corporate having capital requirements for products that have high obsolescence, high taxable income in the near future.

6. **Long Term Lease:** These are for assets that have low depreciation eligibility like plant and machinery, cars, furniture and fixtures etc. and have a long economic life. Corporate who are interested in leveraging the balance sheet and have a higher operational profit prefer this one.

3.4. Factors determining Lease

As the lessee, the following factors determine the most effective type of lease for the company. These factors include: the life of the equipment; what one intend to do with the equipment at the end of the lease; one's tax situation; one's cash flow; and the company's specific needs as they relate to future growth. Further, one's needs also determine what happens at the end of the lease. As a lessee, one's options include: returning the equipment to the lessor; purchasing the equipment at fair market value or at a nominal fixed price; or renewing the lease.

In most cases, the lessee selects and orders the equipment before contacting the lessor. Unless provided for in the lease agreement, the lessor doesn't normally provide equipment warranties which are between the lessee and the manufacturer.

By signing the lease, the lessee assigns its purchase rights to the lessor, who already owns or who then buys the equipment as specified by the lessee. When the equipment is delivered, the lessee formally accepts it and makes sure it meets all specifications. The lessor pays for the equipment, and the lease takes effect.

3.5. Merits of Leasing

The following are the merits of leasing. They are:

1. **It is flexible:** Companies have different needs, different cash flow patterns, and different yet irregular-streams of income. For example, start-up companies typically are characterized by little cash and limited debt lines. Mature companies might have other needs: to keep debt lines free, to comply with debt covenants, and to avoid committing to equipment that may quickly become obsolete. Therefore, business conditions-cash flow, specific equipment needs, and tax situation–may help define the terms of lease. Moreover, a lease provides

the use of equipment for specific periods of time at fixed rental payments. Therefore, leasing allows flexibility in the management of equipment.

2. **It is practical:** By leasing, one transfers the uncertainties and risks of equipment ownership to the lessor, which allows one to concentrate on the productive part of the business.
3. **It is cost effective:** Equipment is costly and some of the costs are unexpected. When one lease, risk of getting caught with obsolete equipment is lower because one can upgrade or add equipment to best meet one's needs. Further, equipment needs can change over time due to changes in the company policy, such as diversification. Sophisticated business managers have learned that the primary benefits of higher productivity and profit come from the use of equipment, not owning it.
4. **It has tax advantages:** Rather than deal with depreciation schedules and Alternative Minimum Tax (AMT) problems, the lessee, simply make the lease payment and deduct it as a business expense, thus saving a lot in tax. The lessor can pass on part of the tax benefits to the lessee through reduced rentals.
5. **It helps conserve operating capital.** Leasing keeps lines of credit open, and one need not tie up one's cash in equity. Also, one can avoid costly down payments leading to increased operating capital.
6. It frees working capital for more productive use.
7. It provides 100% funding as opposed to other sources of capital that usually provide only 60-70 percent.
8. It is simple to negotiate and administer.
9. Most expenses associated with the leased equipment can be incorporated into the lease and amortized over the lease period.

3.6. Advantages to Lessor and Lessee

3.6.1 Advantages to Lessor:

1. Lease improves profitability due to attached tax benefits.
2. As a financing technique, it is more rewarding and attractive to the lessor.
3. It is flexible and can be opened or closed quickly.
4. It is also one of the marketing strategies for the manufacturers.
5. Lessee is an additional financial product involving ownership and risk taking for a reward in terms of rewards.

3.6.2 Advantages to Lessee:

1. It is flexible and can be adjusted through cash flows.
2. Leasing provides 100% finance for the cost of equipment.
3. Leasing preserves and improves the cash position and liquidity of the company.
4. It does not change the Debt equity Ratio.
5. It helps in tax planning and provides hedge against inflation.

5.4. UNDERWRITING

Underwriting: The term underwriting means under taking the responsibility by a person or firm or an institution that if the shares or debentures offered to the public for subscription are not fully subscribed for the underwriter will subscribe for such unsubscribed shares or debentures. The underwriting is thus in the inadequate subscription

It is another mode of issuing the securities during the issue, more particularly this mode of issue is found to be an avenue to off-load the risk of managing the issue of securities as well as to secure the issue as fully subscribed

4.1. *Underwriters*

Underwriters are the intermediaries in the primary market. They provide assurance to the companies, which approach the capital market for raising the financial resources. They render valuable services to the newly started companies, which require believable advice. Underwriters assure the company full subscriptions for a commission

Underwriting is an agreement, entered into by a company with a financial agency, in order to ensure that the public will subscribe for the entire issue of shares or debentures made by the company.

The financial agency is known as the underwriter and it agrees to buy that part of the company issues which are not subscribed to by the public in consideration of a specified underwriting commission.

The underwriting agreement, among others, must provide for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to subscribe to the issue after being intimated by the issuer, the amount of commission and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations.

The underwriting commission may not exceed 5 percent on shares and 2.5 percent in case of debentures. Underwriters get their commission irrespective of whether they have to buy a single security or not.

4.2. Benefits of Underwriting

Underwriting has become very important in recent years with the growth of the corporate sector. It provides several benefits to a company:-

1. It relieves the company of the risk and uncertainty of marketing the securities.
2. Underwriters have an intimate and specialized knowledge of the capital market. They offer valuable advice to the issuing company in the preparation of the prospectus, time of floatation and the price of securities, etc. They also provide publicity service to the companies which have entered into underwriting agreements with them.
3. It helps in financing of new enterprises and in the expansion of the existing projects.
4. It builds up investors' confidence in the issue of securities. The association of well-known underwriters lends prestige to the company and the investors feel that the issue is sound enough for profitable investment. Also, the securities underwritten by reputed underwriters receive better response from the public.
5. The issuing company is assured of the availability of funds. Important projects are not delayed for want of funds.
6. It facilitates the geographical dispersal of securities because generally, the underwriters maintain contacts with investors throughout the country.

4.3. Types of underwriting

- **Syndicate Underwriting:-**is one in which, two or more agencies or underwriters jointly underwrite an issue of securities. Such an arrangement is entered into when the total issue is beyond the resources of one underwriter or when he does not want to block up large amount of funds in one issue.
- **Sub-Underwriting:-**is one in which an underwriter gets a part of the issue further underwritten by another agency. This is done to diffuse the risk involved in underwriting. The name of every under-writer is mentioned in the prospectus along with the amount of securities underwritten by him.

- **Firm Underwriting:-**is one in which the underwriters apply for a block of securities. Under it, the underwriters agree to take up and pay for this block of securities as ordinary subscribers in addition to their commitment as underwriters. The underwriter need not take up the whole of the securities underwritten by him. For example, if the underwriter has underwritten the entire issue of 5 lakh shares offered by a company and has in addition applied for 1 lakh shares for firm allotment. If the public subscribes to the entire issue, the underwriter would be allotted 1 lakh shares even though he is not required to take up any of the shares.

4.4. Types of underwriters

Underwriting of capital issues has become very popular due to the development of the capital market and special financial institutions. The lead taken by public financial institutions has encouraged banks, insurance companies and stock brokers to underwrite on a regular basis. The various types of underwriters differ in their approach and attitude towards underwriting:-

- Development banks like **IFCI**, **ICICI** and **IDBI**:-they follow an entirely objective approach. They stress upon the long-term viability of the enterprise rather than immediate profitability of the capital issue. They attempt to encourage public response to new issues of securities.
- Institutional investors like **LIC** and **AXIS**:-their underwriting policy is governed by their investment policy.
- Financial and development corporations:-they also follow an objective policy while underwriting capital issues.
- Investment and insurance companies and stock-brokers:- they put primary emphasis on the short term prospects of the issuing company as they cannot afford to block large amount of money for long periods of time.

To act as an underwriter, a certificate of registration must be obtained from **Securities and Exchange Board of India (SEBI)** . The certificate is granted by SEBI under the **Securities and Exchanges Board of India (Underwriters) Regulations, 1993**. These regulations deal primarily with issues such as registration, capital adequacy, obligation and responsibilities of the underwriters. Under it, an underwriter is required to enter into a valid agreement with the issuer entity and the said agreement among other things should define the allocation of duties and responsibilities between him and the issuer entity. These regulations have ben further amended by the **Securities and Exchange Board of India (Underwriters) (Amendment) Regulations, 2006**.

4.5. Underwriting is a good technique of marketing the securities. The importance of under-writing can be adjudged by the following advantages

1. **Assurance of Adequate Finance.** Underwriting is a guarantee given buys the underwriters to take up the whole issue or remaining shares, not subscribed by public. In the absence an underwriting agreement, a company may face a situation where even minimum subscription is not received and, it will have to go, into liquidation. In case of an existing company, it may have to postpone its projects for which the issue was meant. As a result of an underwriting contract, a company has not to wait till the shares have been subscribed before entering into the required contracts for purchase of fixed assets etc. it can go ahead with its plan confidently. Thus, underwriting agreement assures of the required funds within a reasonable or agreed time.
2. **Benefit of Expert Advice.** An incidental advantage of underwriting is that the issuing company gets the benefit of expert advice. An underwriter of repute would go into the soundness of the plan put forward by the company before

entering into an agreement and suggest changes wherever necessary, enabling the company to avid certain pitfalls.

3. **Increase in Goodwill of the Company.** The good underwriters being men or firms of financial integrity an established reputation. As we have already explained that underwriters satisfy themselves with the financial integrity of the company and viability of the plan, the investors therefore, run much less risk when they buy shares or debentures which have been underwritten by them. They assure of the soundness of eh company. Thus, good underwriters increase the goodwill of the company.

4. **Geographical Dispersion of Securities.** Generally, underwriters maintain working arrangement wit other underwriters and broken throughout the country and in other countries too and as such, they are able to tap the financial resources for the company not only in on particular area but also in other areas as well. In this way marketability of securities increases and geographical dispersion of shares and debentures in promoted.

5. **Service to Prospective Buyers.** Underwriters render useful services to the perspective buyers of securities by giving them expert advice regarding the safe investment in sound companies. Sometimes they publish information and their expert opinion in respect of various companies. Thus, they render useful services to the buyers of securities too.

5.5. CREDIT RATING

Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity.

Definition: 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.

Credit rating is the opinion of the rating agency on the relative ability and willingness of tile issuer of a debt instrument to meet the debt service obligations as and when they arise. Rating is usually expressed in alphabetical or alphanumeric symbols. Symbols are simple and easily understood tool which help the investor to differentiate between debt instruments on the basis of their underlying credit quality. Rating companies also publish explanations for their symbols used as well as the rationale for the ratings assigned by them, to facilitate deeper understanding.

In other words, the rating is an opinion on the future ability and legal obligation of the issuer to make timely payments of principal and interest on a specific fixed income security. The rating measures the probability that the issuer will default on the security over its life, which depending on the instrument may be a matter of days to thirty years or more.

In fact, the credit rating is a symbolic indicator of the current opinion of the relative capability of the issuer to service its debt obligation in a timely fashion, with specific reference to the instrument being rated. It can also be defined as an expression, through use of symbols, of the opinion about credit quality of the issuer of security/ instrument.

5.1 Functions of a Credit Rating Agency

A credit rating agency serves following functions:

1. **Provides unbiased opinion:** An independent credit rating agency is likely to provide an unbiased opinion as to relative capability of the company to service debt obligations because of the following reasons:
    i. It has no vested interest in an issue unlike brokers, financial intermediaries.
    ii. Its own reputation is at stake.

2. **Provides quality and dependable information**:. A credit rating agency is in a position to provide quality information on credit risk which is more authenticated and reliable because:
   i. It has highly trained and professional staff who has better ability to assess risk.
   ii. It has access to a lot of information which may not be publicly available.

3. **Provides information at low cost**: Most of the investors rely on the ratings assigned by the ratings agencies while taking investment decisions. These ratings are published in the form of reports and are available easily on the payment of negligible price. It is not possible for the investors to assess the creditworthiness of the companies on their own.

4. **Provide easy to understand information**: Rating agencies first of all gather information, then analyze the same. At last these interpret and summaries complex information in a simple and readily understood formal manner. Thus in other words, information supplied by rating agencies can be easily understood by the investors. They need not go into details of the financial statements.

5. **Provide basis for investment**: An investment rated by a credit rating enjoys higher confidence from investors.
   Investors can make an estimate of the risk and return associated with a particular rated issue while investing money in them.

6. **Healthy discipline on corporate borrowers:** Higher credit rating to any credit investment enhances corporate image and builds up goodwill and hence it induces a healthy/ discipline on corporate.

7. **Formation of public policy:** Once the debt securities are rated professionally, it would be easier to formulate public policy guidelines as to the eligibility of securities to be included in different kinds of institutional port-folio.

5.2. Rating Agencies in India

The Indian credit rating industry has evolved over a period of time. Indian credit rating industry mainly comprises of CRISIL, ICRA, CARE, ONICRA, FITCH & SMERA. CRISIL is the largest credit rating agency in India, with a market share of greater than 60%. It is a full service rating agency offering its services in manufacturing, service, financial and SME sectors. SMERA is the rating agency exclusively established for rating of SMEs.

5.2.1 CRISIL: CRISIL is the largest credit rating agency in India. It was established in 1987. The world's largest rating agency Standard & Poor's now holds majority stake in CRISIL. Till date it has rated more than 5178 SMEs across India and has issued more than 10,000 SME ratings.

5.2.2. CARE Ratings: Incorporated in 1993, Credit Analysis and Research Limited (CARE) is a credit rating, research and advisory committee promoted by Industrial Development Bank of India (IDBI), Canara Bank, Unit Trust of India (UTI) and other financial and lending institutions. CARE has completed over 7,564 rating assignments since its inception in 1993.

5.2.3. ICRA: ICRA was established in 1991 by leading Indian financial institutions and commercial banks. International credit rating agency, Moody's, is the largest shareholder. ICRA has a dedicated team of professionals for the MSME sector and has developed a linear scale for MSME sector which makes the benchmarking with peers easier.

5.6. OTHER FINANCIAL SERVICES

6.1 NSDL (National Securities Depository Limited)

National Securities Depository Limited (NSDL) is an Indian central securities depository based in Mumbai. It was established in 1996 as the first electronic securities depository in India with national coverage based on a suggestion by a national institution responsible for the economic development of India.

NSDL, the first and largest depository in India, established in August 1996 and promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standards that handles most of the securities held and settled in dematerialized form in the Indian capital market.

Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems like bad delivery and delayed transfer of title till recently. The enactment of Depositories Act in August 1996 paved the way for establishment of NSDL, the first depository in India. This depository promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standard that handles most of the trading and settlement in dematerialized form in Indian capital market.

Using innovative and flexible technology systems, NSDL works to support the investors and brokers in the capital market of the country. NSDL aims at ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimise risk and reduce costs. At NSDL, we play a quiet but central role in developing products and services that will continue to nurture the growing needs of the financial services industry.

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates.

It has established a national infrastructure using international standards that handles most of the securities held and settled in dematerialized form in the Indian capital market.

About NSDL as on June 30, 2014

1. Number of certificates eliminated (Approx.): 1,653 Crore
2. Investor's Accounts: 1, 31, 16, 821
3. Number of companies in which more than 75% shares are dematted: 12,531
4. Average number of accounts opened per day since November 1996: 3,573
5. DP Service Centers: 14, 433
6. Presence of Demat account holders in the country: 86% of all pincodes in the country

6.1.1. History: Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems such as bad delivery and delayed transfer of title. The enactment of Depositories Act in August 1996 paved the way for establishment of National Securities Depository Limited (NSDL), the first depository in India. It went on to established infrastructure based on international standards that handles most of the securities held and settled in de-materialized form in the Indian capital markets.

NSDL has stated it aims are to ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimize risk and reduce costs. NSDL plays a quiet but central role in developing products and services that will continue to nurture the growing needs of the financial services industry.

In the depository system, securities are held in depository accounts, which are similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates. In August 2009, number of Demat accounts held with NSDL crossed one crore.

6.1.2. Basic Services

Under the provisions of the Depositories Act, NSDL provides various services to investors and other participants in the capital market like, clearing members, stock exchanges, banks and issuers of securities. These include basic facilities like account maintenance, dematerialization, dematerialization, settlement of trades through market transfers, off market transfers & inter-depository transfers, distribution of non-cash corporate actions and nomination/ transmission.

The depository system, which links the issuers, depository participants (DPs), NSDL and Clearing Corporation/Clearing house of stock exchanges, facilitates holding of securities in dematerialized form and effects transfers by means of account transfers. This system which facilitates scripless trading offers various direct and indirect services to the market participants.

1. **Account Maintenance:** To avail of the various services offered by NSDL an investor/a broker/an approved intermediary (for lending & borrowing) has to open a NSDL depository account with any of its DPs.
2. **Dematerialization:** Dematerialization is the process by which a client can get physical certificates converted into electronic balances.
3. **Re-materialization:** Re-materialization is the process by which a client can get his electronic holdings converted into physical certificates. The client has to submit the re-materialisation request to the DP with whom he has an account. The DP enters the request in its system which blocks the client's holdings to that extent automatically. The DP releases the request to NSDL and sends the request form to the Issuer/R&T agent. The Issuer/R&T agent then prints the certificates, despatches the same to the client and simultaneously electronically confirms the acceptance of the request to NSDL. Thereafter, the client's blocked balances are debited.
4. **Market Transfers:**Trading in dematerialised securities is quite similar to trading in physical securities. The major difference is that at the time of settlement, instead of delivery/receipt of securities in the physical form, the same is affected through account transfers.
5. **Off-Market Transfers:** Trading in dematerialised securities is quite similar to trading in physical securities. The major difference is that at the time of settlement, instead of delivery/receipt of securities in the physical form, the same is affected through account transfers.
6. **Inter-Depository Transfers:** Transfer of securities from an account in one depository to an account in another depository is termed as an inter-depository transfer. This

facility is quite similar to the account transfers within NSDL.

7. **Transmission:**One of the lesser-known but widely experienced problems with respect to dealing in share certificates is transmission of shares. The Companies Act distinguishes transmission of shares from transfer of shares. While transfer of shares relates to a voluntary act of the shareholder, transmission is brought about by operation of law. The word 'transmission' means devolution of title to shares otherwise than by transfer, for example, devolution by death, succession, inheritance, bankruptcy, marriage, etc. While transfer of shares is brought about by delivery of a proper instrument of transfer (viz, transfer deed) duly stamped and executed, transmission of shares is done by forwarding the necessary documents (such as a notarised copy of death certificate) to the company. On registration of the transmission of shares, the person entitled to transmission of shares becomes the shareholder of the company and is entitled to all rights and subject to all liabilities as such shareholder.

8. **Corporate Actions:** Corporate actions are benefits given by a company to its investors. These may be either monetary benefits like dividend, interest or non-monetary benefits like bonus, rights, etc. NSDL facilitates distribution of corporate benefits.

6.1.3. Value Added Services:

Depository is a facility for holding securities electronically in which securities transactions are processed by book entry. In addition to the core services of electronic custody and trade settlement services, NSDL provides special services like pledge, hypothecation of securities, automatic delivery of securities to clearing corporations, distribution of cash and non-cash corporate benefits (Bonus, Rights, IPOs etc.), stock lending, demits of NSC/KVP, demits of warehouse receipts and Internet-based services such as **SPEED-e** and **IDeAS**.

NSDL has also set-up a facility that enables brokers to deliver contract notes to custodians and/or fund managers electronically. This facility called **STEADY** (Securities Trading-information Easy Access and DeliverY) was launched by NSDL on November 30, 2002.**STEADY** is a means of transmitting digitally signed trade information with encryption across market participants electronically, through Internet.

1. **Automatic Delivery Out Instructions (Auto DOs**): Delivery-out instructions for moving securities from CM Pool Account to CM Delivery Account can be generated automatically by the respective Clearing Corporations based on the net delivery obligations of its Clearing Members. The Clearing Corporation can generate Auto DOs on behalf of those Clearing Members who have authorised it in this regard. The Auto DOs will be generated around the time of download of the delivery obligations to the Clearing Members. Such Clearing Members will not be required to give delivery-out instruction forms to the Participants for Pay-in to the Clearing Corporation in respect of the automatically generated DOs. The Clearing Members can know the Auto DOs either by way of download from the Clearing Corporation or through the Auto DO Report from the Participants or from SPEED facility on Internet

2. **Dividend Distribution:** At present, NSDL merely facilitates distribution of cash corporate benefits like dividend etc., to shareholders. Details in respect of all

beneficial owners of the security as on the record date of the concerned company are provided by NSDL to the company/its registrar and share transfer agent (R & T agent). Thereafter, the company/R & T agent dispatches dividend entitlements to the eligible beneficial owners in the same way as is done for shareholders holding physical certificates.

NSDL intends to extend the service of distributing cash benefits directly to beneficial owners. On a pilot basis NSDL had extended the dividend distribution service to shareholders of certain companies. Keeping in view this successful experiment, NSDL, in future, may consider extending this service to other issuers too who have joined the NSDL depository system.

3. **Stock Lending and Borrowing**: The transactions involving lending and borrowing of securities are executed through approved intermediaries duly registered with SEBI under the Securities Lending Scheme, 1997. Such an intermediary may deal in the depository system only through a special account (known as Intermediary Account) opened with a DP. An intermediary account may be opened with the DP only after the intermediary has obtained SEBI approval and registered itself with SEBI under the Securities Lending Scheme. The intermediary has also to obtain approval of NSDL

4. **Pledge/Hypothecation: Securities** held in a depository account can be pledged/hypothecated to avail of loan/ credit facility. Pledge of securities in NSDL depository requires that both the borrower (pledger) and the lender (pledgee) should have account in NSDL depository.

5. **Public Issues:** Investors have an option to seek allotment of public issues in electronic form. As per SEBI guidelines trades in shares issued through public issue shall be settled only in demat form. Therefore, it is advisable that investors seek allotment in demat form.

6.2. STCI Finance Ltd. (formerly known as Securities Trading Corporation of India Limited), is a systemically important non-deposit taking NBFC registered with Reserve Bank of India. Presently STCI Finance Ltd is classified as a loan NBFC.

STCI Finance Limited was promoted by Reserve Bank of India in May 1994 with the objective of fostering an active secondary market in Government of India Securities and Public Sector bonds. The Company had a subscribed and paid up capital of Rs 500 crores with RBI owning the majority stake of 50.18%. In 1996, STCI was authorized by RBI as one of the first Primary Dealers in India.

As the leading Primary Dealer in the country, the Company was a market maker in government securities, corporate bonds and money market instruments apart from carrying out proprietary trading in equity both in the cash & derivatives (F&O) segment. The Company's other lines of activities included trading in interest rate swaps-both for hedging and market making. The Company enjoyed a successful track record of achieving profits during consecutive years spanning nearly a decade. It had the distinction of achieving secondary market turnover of more than Rs.2.00 lakh crore in sovereign paper.

RBI divested its entire shareholding in STCI in two stages-first in 1997 to bring it down from 50.18% to 14.41% and the balance in 2002 to the existing shareholders. Bank of India became the largest shareholder in the company.

In April 2006, the STCI took over UTI Securities Limited from Specified Undertaking of Unit Trust of India (SUUTI). The Company hived off Primary Dealership as a separate 100% subsidiary by the name of STCI Primary Dealer Limited (STCI-PD) which started functioning from June 25, 2007.

The Company sold off its stake in UTI Securities Limited to Standard Chartered Bank (Mauritius) limited in three stages between 2008 and 2010. STCI assumed 100% stake in UTI Commodities, a commodity broking entity (later known as STCI Commodities Ltd) which was wholly owned by UTI Securities.

Since 2007, the Company has been undertaking lending and investment activities as a Systemically Important-Non Deposit taking Non Banking Financial Company **(NBFC-ND-SI)** with main focus on lending and financing activities. Over a period of time, the size of the Company's loan book has grown and lending/ financing activity has become its core business. With a view to reflecting the widening mix of its business, the name of the Company has been changed from Securities Trading Corporation of India Limited to '**STCI Finance Limited'** with effect from October 24, 2011.

Subsidiaries:

a. **STCI Primary Dealer Limited (STCI PD)**: This company is a wholly owned subsidiary of STCI Finance Limited established in October 2006 consequent to the hiving off of the Company's primary dealership business in line with the Reserve Bank of India guidelines on diversification of business activities by primary dealers. The Company commenced its operations with effect from June 25, 2007 and undertakes trading in government securities, corporate bonds, money market instruments, interest rate swaps and trading in equity (both cash and F&O). The Company also undertakes fee based activities of Portfolio Management Services and Mutual Fund Distribution.

b. **STCI Commodities Limited:** This is a wholly owned subsidiary of STCI Finance Limited which provides brokerage, investment and advisory services in Indian Commodities Markets. The Company is a member of two of India's largest online Commodities exchanges namely MCX and NCDEX in addition to membership in NCDEX Spot Exchange. Recently, the parent Company has taken a policy decision to exit the commodity broking business by sale of this subsidiary.

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His research interests are focused on financial management, banking, education, economics, financial system, financial services, with the current situation. Mr R. Chauhan was also awarded the best paper presentation in the conference at Udaipur, Rajasthan in the year 2016 and Received Best Academic Performance Award-2019 from Parul Institute of Business Administration, Parul University and also receive Research Excellence award-2021 from Parul University, he has received 14 more national and international awards from other government recognized bodies. He was invited as a technical Session chairman in national conference in Netaji Subhas University-Jamshedpur, Jharkhand on 21st September, 2019. He was invited as a resource person in national conference on the topic of Recent & innovation practice in higher education, organized by Ashoka International Foundation-Nasik, Maharashtra, on 14th December, 2019. He was also invited as a guest of honor in international conference at Mumbai on 3rd and 4th February, 2020.

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In addition, he was being an active role in the world of education in the Lampung region. The author has written several books, and he is also actively writing in several reputable international scientific journals in the field of Economics and Business and the Field of Computer Technology, both as First author and Co-Author. Currently, the author is also active as a resource person at various National and International scientific meetings in the fields of Economics, Business, and other fields of science related to business technology. In addition to producing scientific works, he is also active in various Lecturer professional organizations such as the Indonesian Institute of Accountants (IAI), APTIKOM Lampung, Management of the Association of Experts and Lecturers of the Republic of Indonesia (ADRI) Lampung, Association of Indonesian Private Universities (APTISI) Region II-B Lampung and head of KAFEGAMA Lampung organization. In addition, the author is also an active reviewer in various national scientific journals in the fields of Economics, Business, Management, and Accounting.

Catatan:

A financial system is a composition of various institutions, markets, regulations and laws, practices, money managers, analysts, transactions, and liabilities. This book thoroughly describes the Indian financial system. The Indian Financial System is organized in five parts, consist of: Financial System, The Indian Financial System, Indian Money Market, Indian Capital Market, and Fee-Based Financial Services. In addition, important topic and depth discussion of the Indian Financial System includes the following: Constituents of financial system Functions of the Indian financial system Role of the money market in economy Producing information and allocating capital Capital market in India This book offers a comprehensive and well-crafted topic the Indian Financial System. This book is also suitable for readers interested in learning about money, banking, and the financial system in the context of contemporary events, policy, and business. Researcher and students can selectively read this book for their references and studies.

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