5th SEM B.COM FINANCE

CALICUT UNIVERSITY

FINANCIAL MARKETS AND SERVICES

2017 ADMISSION

Prepared by

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Syllabus

BCM5B10 FINANCIAL MARKETS AND SERVICES

Lecture Hours per week: 4, Credits: 4 Internal: 20,

External: 80, Examination 2.5 Hours

Objectives:

- To provide basic knowledge about the structure, organization and working of financial system in India.

Module I Financial System: Meaning and Significance - Functions of the financial system - Financial concepts - Financial Assets - Financial markets - Classification - Financial instruments - Weakness of Indian Financial system – Financial services – meaning – Types. (10 hours, 12 marks)

Module II Money Market: Definition - Features - Objectives - Features of a developed .money market - Importance of Money market - Composition of Money market - Operations and Participants - Money market Instruments - Features of Indian money market - Recent developments (15 Hours, 20 marks)

Module III Capital Market: New issue market - meaning - functions - methods floating new issue - intermediaries in the new issue market - Merchants bankers and their functions - Recent trends in new issue market - Stock Exchanges - Functions - Structure of Stock ExchangesBSE - NSE - Listing of securities - Advantages of listing - Methods of trading in stock exchanges - On line trading - Stock indices - Venture Capital - Concept and meaning. (20 Hours, 23 marks)

Module IV Financial Institutions: Commercial banks - Development financial institutions - Non-Banking Financial Corporations - Mutual Funds, Insurance Companies - Objectives and functionsLease Financing-meaning- Factoring and forfeiting (only a brief outline) (14 Hours, 15 marks)

Module V Regulatory Institutions - RBI - Role and Functions - The Securities and Exchange Board of India: Objectives - Functions - Powers - SEB1 Guidelines for primary and secondary market. (5 Hours, 10 marks))

Reference Books:

1. Kohn, Meir: Financial Institutions and Markets, Tata McGraw Hill.
2. Bhole L.M: Financial Institutions and Markets, Tata McGraw Hill.
3. Desai, Vasantha: The Indian Financial System, Himalaya Publishing House.
4. Machiraju.R.H: Indian Financial System, Vikas Publishing House.
5. Khan M.Y: Indian Financial System, Tata McGraw Hill.
6. Varshney, P.M., & D. K. Mittal, D.K.: Indian Financial System, Sulthan Chand & Sons
7. Gordon E. & Natarajan K.: Financial Markets & Services, Himalaya Publishing House.
8. Pathak. V. Bharati: Indian Financial System. Pearson Education.

(Theory and problems may be in the ratio of 50% and 50% respectively

<u>Module 1</u>

FINANCIAL MARKETS AND SERVICES

Introduction

- The financial system acts as an intermediary for inflow and outflow of funds.
- It mobilizes the funds of the nation and channelizes the fund for productive purposes
- Financial system includes banks, security exchanges, pension funds, insurers, central bank and national regulators.

Meaning and definition

- Financial system is a set of institutions, instruments and markets
- It is a set of markets for financial instruments or assets together with individuals and institutions.
- It defined as " as a set of institutional arrangement through which financial surplus in the economy are mobilized from surplus units and transferred to deficient spenders"

Significance of financial system

- Need for well-developed and well functioned financial market
- Need for more investment and production
- Need for capital
- Need for infrastructure development and growth
- Growth of trade
- Helps to augment employment growth
- Ensures balanced growth
- Attracting foreign capital
- Helps balanced regional development
- Helps in uniform interest rates
- Helps to attract foreign capital
- Helps in fiscal discipline and control of economy

Functions of financial system

- Providing liquidity
- Mobilization of savings
- Risk transformation
- Price discovery of financial assets
- Promoting savings
- Establishing a link between the savers and the investors

Financial concepts

1. Financial assets
   - Classification of financial assets
     - Primary/direct assets
     - Secondary/indirect assets
     - Marketable assets
     - Non-marketable assets
     - Money/cash asset

- Debt asset
- Stock asset

2. Financial markets
   - Functions of financial markets
     - Borrowing and lending
     - Price determination
     - Information aggregation and coordination
     - Risk sharing
     - Liquidity
     - Efficiency
   - Types of financial markets
     - Money market
     - Capital market
     - Financial mortgages market
     - Financial guarantees market
     - Foreign exchange markets
     - Commodity markets
     - Debt market
3. Financial instruments/securities
   - Features
     - Transferability
     - Minimum transaction cost
     - Ready market
     - Liquidity
     - Security value
     - Tax status
     - Uncertainty
     - Rate of return
     - Future trading
     - Maturity period
     - Simplicity
   - classification
     - primary securities
     - secondary securities
4. Financial intermediaries/institutions
   - Classification
     - Banks
     - Non- banking intermediaries
     - Capital market
     - Money market
5. Financial services
   - Types
     - Factoring
     - Leasing
     - Forfaiting
     - Hire purchase
     - Credit card
     - Merchant banking
     - Book building

- Asset liability management
- Housing finance
- Portfolio finance
- Underwriting
- Credit rating
- Interest& credit swap
- Mutual fund
- Fee based services
- Fund based services

6. Financial rate of return

Growth of the Indian financial system

- Dominance of banking sector
- Growth of non-bank intermediation
- Well diversified structure of financial institutions
  - Financial institutions
  - Non-banking financial companies
  - Mutual funds
  - Introduction of the online trading
  - Growth of service sector

Weakness of Indian financial system

- Lack of institutional investors
- Lack of coordination between different financial intermediaries
- Lack of emergence of financial corporations
- Dominance of monopolies
- Lack integration of the segments of the financial system
- Dominance of development banks
- dominance of the public sector firms
- market irregularities
- neglect for small and new enterprises
- problem with multiple regulators
- cyber threats

Module 2

MONEY MARKET

Money market

- The institutional arrangement, deal with short-term funds.
- Deals with near substitutes for money or near money like trade bills, promissory notes and government papers etc.
- The instruments are drawn for a period not exceeding one year.
- It doesn't refer a particular place where short term funds are dealt with.
- It includes all individuals, institutions and intermediaries dealing with short term funds
- Examples: Mumbai money market, New York money market, London money market etc.

Definition

The RBI defines "the centre for dealing, mainly of short term character, in monetary assets, it meets the short term requirements of borrowers and provides liquidity or cash the lenders."

Feature of money market

- Market for short funds or financial assets
- Having maturity period of 1 year
- Borrower will get funds for periods varying from a day, a week, a month, 3-6 months.
- Collection of instruments like Call money, notice money, repos, term money, commercial bills, CD's, CP's, TB's, inter -bank participation certificate, inter corporate deposits, swaps, bill of exchanges, treasury bills etc.
- It consist of sub markets like call money market, trade bills market etc.
- The borrowers are traders, manufactures, speculators and govt. institutions.
- The important components are central bank, commercial bank, non-banking financial institutions, discount houses and acceptance houses.
- The demand and supply of money shape the market.

Objectives/functions of money market

- Provide space to overcome short term deficits
- Provide place to employ short term surplus funds
- Facilitate the central bank to influence and control liquidity in the financial system
- Provide access to consumers of short term funds to meet their requirements rapidly, sufficiently at rational cost.
- Facilitate economic development through short term funds
- Achieve equilibrium between demand and supply of short term funds
- Facilitate effective implementation of RBI's monetary policy
- Provide avenues for short term funds with fair returns to investors
- Helps capital formation through savings and investment
- Helps employment generation
- Helps to control inflation
- Provide funds to govt. to meet its deficits
- Helps Development of non-banking intermediaries
- Provide stable source of funds to banks.

Features of a developed money market

- Well organized banking system
- Existence of a central bank
- Availability of proper credit instruments
- Proper coordination of different sectors
- Lack of diversity in money rates of interest
- Presence of bills market
- Sufficient resources
- Existence of secondary market
- Ample supply of funds
- Other factors

Importance of money market

- Development of capital market
- Financing trade
- Financing industry
- Helps commercial banks
- Helps central bank
- Guide and help to govt.
- Encourages savings and investment

Composition of money market

a) Call money market
b) Commercial bill market
c) Treasury bill market

Call money market

- It is the market for very short term funds.
- It referred as "loans or money at call and short notice"
- These are granted for overnight use or 24 hours or for a maximum of 7 days.
- The rate at which funds are borrowed and lend in this market is called call money market
- Collateral securities are not insisted
- Commercial banks can borrow from the call market to meet their statutory liquidity requirements

➢ Features
  - Enables banks and institutions to meet their day to day deficits and surpluses of money
  - Commercial banks, co-operative banks and primary dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements
  - Specified all India financial institutions, mutual funds and certain specified entries are allowed to access
  - Interest are market determined
  - It is a completely inter-bank market
  - Non-bank entities are not allowed to access
  - Basically it is an over the telephone market
  - Call money market in India situated Mumbai, Kolkata, Ahmadabad, Delhi, Chennai etc.

- When the banks need of temporary funds will take this loan from that have excess funds. This is called inter- bank call money market

- participants
  - commercial banks and cooperative banks
  - SBI provides all call advances against govt. securities
  - IDBI, UTI, DFHI,NABARD,LIC and GIC also entered and supplying 80% of short term funds
  - The main borrowers are public sector banks
- Inter- bank term deposit/loan market
  - The loans between banks
  - Period of loans is over 14 days and generally up to 90 days without any collateral security
  - Lenders cannot recall these loans back before maturity
  - DFHI plays an important role by arranging, lending and borrowing short term funds
- Merits
  - Profitability
  - High liquidity
  - Helps to maintain statutory reserve requirements
  - Safe
  - Helps the central bank
- Demerits
  - Confined to big cities
  - Lack of integration
  - Call money rates volatile in nature
  - Small size
  - Commercial banks are not inclined to offer loans to brokers and dealers in bills and securities.

<u>Commercial bill market or discount market</u>

- Helps to meet the short term financial requirements of the individuals, firms and govt.
- Commercial banks are invest their surplus funds in these bills
- Types are ; demand and usance (time) bills, clean bills and documentary bills, inland and foreign bills, export and import bills, indigenous bills, accommodation bills and supply bills, short-term bills etc.
- Major two types;
  1) Commercial/short term bill market
     a) Discount market
     b) Acceptance market
  2) Treasury bill market
- Importance
  - High liquidity
  - Certainty in payment
  - Self-liquidating
  - Ideal for investment
  - Quick yield
  - Control
  - More elastic monetary system
- Limitations
  - Lack of bill culture

- No rediscounting between banks
- Absence of secondary market
- No proper development of foreign trade
- Domination of indigenous bankers
- Cumbersome procedures
- Commercial banks attitude
- Absence of specialized institutions

➢ Derivative Usance Promissory Notes (DUPN)
- Introduced by RBI with an intention of reducing paper movements and facilitating rediscounting
- These are sold to investors in convenient lots of maturities from 15 days to 90 days

<u>Treasury bill market</u>

- Deals with treasury bills (TB)
- TBs are short term borrowings of the central govt. and are issued by RBI
- It is issued to meet the short term requirements of central bank
- It is a kind of promissory note issued by govt.
- Maturity period vary as 14,91,182, and 364 day

➢ Types
  a) Adhoc
  b) Regular

➢ participants
RBI, SBI, commercial banks, state govt, DFHI, STCI, LIC, GIC. UTI, IDBI. ICICI, IFCI, NABARD, corporate customers and public

➢ advantages
- safe
- liquidity
- suitable short term investment
- helpful to effective fund management
- help to meet statutory requirements
- Source of short term fund to govt.
- prevaricate facility
- help to control inflation

<u>Money market instruments</u>

1) call/notice money
2) certificate of deposits (CDs)
3) commercial paper (CP)
4) inter-bank participation certificate
5) money market mutual funds (MMMFS)
6) collateral loan market
7) re-purchase agreements (REPOS)/ ready forward transaction

<u>Call/ notice market</u>
- is an amount borrowed or lent on demand for every short period
- if the period is more than one day and up to 14 days it is called “notice money” otherwise the amount is called “call money”
- no collateral security is required
- the interest rate paid on call loans is known as “call rate”

Certificate of deposit (CDs)

- Negotiable money market instrument and issued in dematerialised form or a usance promissory note.
- It can be issued by scheduled (1) commercial banks excluding RRBs and local area banks (2) select all India financial institutions permitted by RBI
- It is the next lowest risk category investment option after treasury bills
- Minimum amount of CD should be 1 lakh
- CDs are virtually risk less in terms of default of payment of interest and principal sum
- Usually issued at face value
- As the depositors are concerned, these are the most convenient instrument
- It is transferable by endorsement and delivery
- Rate of interest on CD is more attractive than on bank deposit

Commercial papers (CPs)

- Unsecured money market instrument issued in the form of promissory note
- It is a new instrument used for financing working capital requirements of corporate enterprises
- It is rarely issued to finance the permanent working capital or for fixed capital
- They are negotiable by endorsement and delivery
- any public or private sector company can issue
- any person, bank, company and other registered incorporated bodies can invest
- issued at a discount to their face value
- The issue companies freely determine the discount rate and the market freely determines the rate in the secondary market.
- CP shall be issued in the form of promissory note. And held in physical or dematerialised form through any of the depositories approved by and registered with SEBI
- It can be issued for maturities between a minimum of 7 days and maximum up to 12 months from the date of issue
- It can freely transferable by endorsement and delivery
  - Types
  - Direct papers
  - Dealer papers
  - Master note
  - Medium term note
  - Asset backed commercial paper

Inter – bank participation certificate

- The scheme was launched to even out the excess surplus funds with the banking system
- The issuing bank is required to repay the amount of the certificate on the due date to the purchaser of PC
- Two types are there; 1) risk sharing 2) without risk sharing
- This is confined to scheduled commercial banks excluding regional rural banks
- It can be issued for 91-180 days
- Rate of interest is determined between issuing bank and the participating bank

Money Market Mutual Funds (MMMFS)

- Type of mutual that solely in money market instruments
- High quality and short maturity
- Types: 1) institutional MMMF, 2) Retail MMMF
- MMMF can be set up by the banks and financial institutions

Collateral loan market

- This sector deals with collateral loans
- Short term loans are granted against collateral securities
- Usually granted by commercial banks to stock exchange dealers and brokers

Re- purchase agreements/ ready forward transactions

- It is a transaction in which two parties agree to sell and repurchase the same security
- Under this agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price
- Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a predetermined price, such a transaction called repo.
- The repo/ reverse repo transaction can only be done at Mumbai between parties approved by RBI
- It helps banks to invest surplus cash
- Helps investor achieve money market returns with sovereign risk
- Helps borrower to raise funds at better rates
- Can use the way for adjusting SLR/CRR positions
- Helps for liquidity adjustment

Components /structure of Indian money market

1) Organized money market
2) Unorganized money market
3) Sub market

Defects of Indian money market

- Existence of unorganized money market
- Non- coordination of organized and unorganized sector
- Multiplicity in rates of interest
- Seasonal stringency of funds
- Absence of bill market
- Inadequate banking facilities
- Absence of well-organized banking system
- Absence of specialized financial institutions
- Absence of movement of funds
- Absence of sufficient sub market
- Inadequacy of credit investments

Recent trends in Indian money market

- Integration of organized and unorganized money markets
- Enlargement of call money market
- Establishment of DFHI
- STCI

- Introduction of new instruments
  1. Treasury bills
  2. Derivative usance promissory notes
  3. Repos
  4. Collateralized borrowing and lending obligation
  5. MMMFs
  6. Deregulation of the interest rate
  7. Offers market rates of interest
- Setting up of credit rating agencies
- Agenda for further action
- Liquidity adjustment facility
- Introduction of interest rate swaps
- Electronic dealing system
- Phased exit of non- banks from the call/ notice money market
- Strengthening of payment system

Module 3

CAPITAL MARKET

Capital market

- It is the market that deals in financial assets, which have a long or indefinite maturity.
- Generally deals with long term securities
- The leading borrowers in the capital market are corporates, central Govt. state Govt. and local bodies
- The major funds coming to the capital market is from individual investors, corporate savers, commercial banks, insurance companies, public provident funds and other agencies.

Classification of capital market

a) Industrial securities market
   - It is the market for industrial securities like equity share, preference shares, debentures and bonds
   - Industrial markets are classified as;
     1) Primary markets/new issue market

        It is the market in which newly created organizations or existing ones offer their issue for the first time.
     2) Secondary market/ stock exchange

        It is the market of the existing or old securities. It means the securities which are already issued through the primary market are traded in this market.

b) Govt. securities market/ gilt edged securities
   - The Govt securities comprise dated securities issued by the govt of India and state Govt.
   - Most of these securities are issued as fixed interest bearing securities, though the Govt sometimes issues zero coupon instruments and floating rate securities also
   - The investors are mainly banks, foreign investors, insurance companies, provident funds and trusts.

c) Long term loans market
   - Generally development banks and commercial banks supply long term loans to corporate investors.
   - This market can be classified as;
     1) Term loans market
     2) Mortgages market
     3) Financial guarantees market

Functions of the capital market

- Investment function
- From the point of view of investors
- From the point of view of nation
- From the point of view of the financial intermediaries
- Acts as link between investors and savers

Features of capital market

- Deals with long term and medium term funds
- It trades in funds both securitized and non-securitized funds
- It channelize the flow of funds from the undesirable activities into desirable activities
- The fund raised is generally used for acquisition of land and building, plant and machinery and other fixed assets.
- The capital market is composed of new or primary issue market, secondary issue market, Govt securities market and long term loans
- Banks, commercial institutions , cooperative institutions and financial institutions are the intermediaries
- Provides liquidity to investments
- Securities are transferable and marketable

Scope and importance of capital market

- Mobilization of savings
- Capital formation
- Offers incentives
- Economic development
- Integrates different parts of the financial system
- Maintain liquidity in investment
- Innovation
- Latest technology
- Economic welfare of the nation

Recent developments of the Indian capital market

- Stock market
- Stock exchanges
- SEBI
- Regulation of intermediaries
- Database of clients
- Prohibition of insider trading
- Clearing houses
- Investor protection funds
- Education
- Discipline
- Account details
- Introduction of depositories
- Stock watch system
- Derivative trading

Defects of Indian capital market

- Range of securities
- Lack of information disclosure
- Greater competition
- Expansion of investor base
- Absence of genuine investors
- Lack of liquidity

- Management, regulation, and surveillance of capital market
- Presence of rigging
- Dominance of insider trading
- Lack of transparency
- Poor response from the small investors
- High of volatility of stock market
- Problems of odd lots
- Supremacy of financial institutions
- Dominance of the public sector
- Unhealthy competition of merchant bankers
- Other defects

NEW ISSUE MARKET

New issue market/primary market

- It is the market in which newly created organizations or existing ones offer their issue for the first time.
- Fresh can be raised from this market by companies, govt and semi govt bodies, public sector undertakings etc. either for cash or for consideration the selling of ion other than cash.
- A corporate company raises its long term fund requirements in 3 ways;
  1) Public issue :- it is the sale of securities to the public
  2) Right issue:- if a company issues additional securities, first it is offered to the existing shareholders
  3) Private placement:-it is the selling of securities privately to known friends, relatives or financial institutions with or without the help of financial intermediaries.

Distinction between primary market and stock exchange

- Function
- Organization
- Service
- Capital contribution
- Market

Functions of new issue market/primary market

- Origination
- Propagation
- Underwriting
- Guaranteeing the issue
- Outright purchase
- Syndicate underwriting
- Institutional underwriters
- The non- institutional underwriters are brokers
- Distribution
- Regulation.

Methods of floating new issue

1) Public issue
2) Offer for sale
3) Private placement
4) Bought out deals
5) Right issue
6) Bonus shares
7) Book building
8) Employee's stock option scheme
9) Offer to employees
10) Offer to customers
11) Offer to creditors

<u>Primary market instruments</u>

1) Equity share
   - Types:
     a) Blue chip shares
     b) Growth shares
     c) Income shares
     d) Cyclical shares
     e) Defensive shares
     f) Speculative shares
     g) Stalwarts
     h) Fast growers
     i) Slow growers
     j) Turn around
     k) Asset plays
2) Equity shares with differential rights
3) Preference shares
4) Debentures (bonds)

<u>Euro issues</u>

- Global deposit receipt (GDR)
  - It is a financial instrument used by private markets to raise capital denominated in US dollars or Euros.
  - It represents the shares of the issuing company
  - The holder can convert the receipt into specified number of shares, which then can be traded into domestic markets.
  - The holders of GDR are entitled to receive dividend in multiple currencies.
  - They have no voting right until it is converted into shares in rupee terms
  - Prior of the Govt is required
  - GDR can be used for financing capital goods imports, capital expenditure including domestic purchase/installation of plant etc.
  - Investment in stock markets and real estate will not be permitted
- American depository receipts (ADR)
  - It is a share of stock of an investment in shares of a non- US corporation
  - ADRs are bought and sold on American markets just like regular stocks, and are issued / sponsored in the US by a bank or brokerage

- Two banks are involved in maintaining an ADR on a US exchange; an investment bank and a depository bank
- The depository bank handles the issuance and cancellation of ADRs certificates, it handles day to day interaction with holders of the ADRs
- To establish an ADR an investment bank arranges to buy the shares on a foreign market and issue the ADR on the US market

➢ Intermediaries in the issue market

a) Managers to the issue

i. Merchant bankers

Functions of merchant banker

- Management of debt and equity offerings
- Placement and distribution
- Corporate advisory services
- Financial structuring
- Refinancing alternatives
- Rehabilitation and turnaround management
- Risk management
- Project advisory services
- Loan syndication
- Providing venture capital

ii. Registration

b) Registrar to the issue

- Registrar to issue are appointed by the company in consultation with merchant bankers
- It means the person appointed by a body corporate or any person or group of persons to carry;
- Collecting applications from investors in respect of an issue
- Keeping a proper record of applications
- Assisting body corporates or persons or group
- To carry out these activities it must be registered with SEBI

Services of registrar to the issue

i. Pre issue functions
ii. Issue functions
iii. Pre allotment functions
iv. Functions related to investment
v. Post allotment functions

c) Underwriter to the issue

- Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them
- It means a person, who engages in the business of underwriting of an issue of securities of a body corporate

d) Bankers to the issue

- A banker with a network of branches across the country may be appointed as banker to the issue

- It is scheduled bank carrying on all or any of the following issue related activities:
  1. Acceptance of application and application monies
  2. Acceptance of allotment or call monies
  3. Refund of application monies
  4. Payment of dividend or interest warrants
- Two types of bankers may be appointed;
  1. Collecting banker who collects the subscriptions in cash, cheques, draft, stock invest etc.
  2. Coordinating bankers who collect information on subscriptions and coordinate the collection work

e) Brokers to the issue

- The persons who are related with the procurement of subscription to the issue from the prospective investors
- They are registered members of the stock exchange
- They bring together prospective buyers and sellers in the new issue market.
- Their appointment is not compulsory, a company can appoint a number of brokers
- The brokerage fee vary in between 1% to 1.5% of the issue prices of securities

➢ Recent trends in primary market

1. Raising of capital
   - public issues
   - private placement
   - mutual funds
2. revival of primary market
3. domination
   - industrial growth
   - buoyancy of the secondary market
   - fiscal incentives
   - tightening of norms
   - major revamp in IPO norms
4. paperless primary market issues

➢ reasons for poor performance

- manifestation of real economy
- failure to mobilize the households savings
- passive situation
- gap in the primary market
- with the introduction of the economic reforms
- data to investors
- developments in the international markets

SECONDARY MARKET

Secondary market

- it consist of both equity as well as debt markets
- it also referred as stock market

- it deals with sale and purchase of already issued equity and debt securities of the corporates and others

➢ difference between primary market and secondary market

Primary market	**Secondary market**
Introduce new shares for issue	Shares already introduced in primary market are deals here
Deals with issuing of securities	Deals with buying and selling of securities
Has no tangible form of organizational set up	Has physical existence as stock exchanges
Security is exists only for a limited period	Have long and continues existence
Is a source of fund to a new or existing company	Not a source of fund for new companies or existing companies

<u>Functions of secondary market</u>

- capital formation
- security price formation
- creation of market place
- safety of transactions
- liquidity

<u>Control over security market</u>

1. recognition of stock exchanges
   ➢ features of stock exchanges
   - it is a centralized market place to trade in securities
   - they are the theatre of trading securities
   - they assist to buy an govt d sale of securities
   - it is an auction market
   - it has its own rules and regulations
   - it has facility for genuine speculation
   - it has govt patronage and control

   ➢ functions of stock exchange
   - to provide ready market
   - liquidity and marketability of securities
   - fair price determination
   - safety of funds
   - source for long term funds
   - channelization of funds to profitable ones
   - helps in capital formation
   - reflects the general state of economy
   - it induces companies to raise their standard of performance
   - services to investors
   - services to companies
   - services to the community

   ➢ organisation of stock exchanges in India
   - the first organized stock exchange was started in Mumbai (BSE-1877)
   - then Ahmadabad stock exchanges started in 1894
   - NSE started in 1992

- structure of stock exchanges
    - as on 2018 there are 14 exchanges
    - BSE and NSE are the largest stock exchanges
    - At present SEBI recognized a total of 8 stock exchanges
- Demutualisation
    - Refers to transition process of an exchange from a “mutually –owned” association to a company “owned by shareholders”
    - Transforming the legal structure of an exchange from a mutual form to a business corporation form
    - After demutualisation the ownership, the management and the trading rights at the exchange are segregated from one another
- BSE (Bombay stock exchange)
    - Established in 1887
    - First stock exchange in the country
    - It is the only stock exchange in India which is given permanent recognition by the Govt.
    - In 2005, BSE was given the status of a full- fledged public company along with a new name as “Bombay stock exchange ltd”
    - It has computerized its trading system by introducing BOLT (Bombay on Line Trading) since march 1995
    - It is a corporatized and demutualized entity
    - It is a platform for trading in equities of small and medium enterprises
    - More than 5500 companies are listed on BSE
    - Its world’s no 1 exchange in terms of listed members
    - In addition to equity and debt, it allows for trading of mutual funds and derivatives
    - It also provides other services to capital market participants including risk management, clearing, settlement, market data services and education
    - Its popular equity index S&P BSE SENSEX
    - It is traded internationally on the EUREX as well as leading exchanges of the BRSC nations
- Stock indices
    - It is a measurement of the value of a section of the stock market
    - It is computed from the prices of selected stocks
    - It is a tool used by investors and financial managers to describe the market and to compare the return on specific investments
    - It is useful in understanding the level of prices and the trend of price movements of the market
    - It act as indicator of the performance of the company or a sector of the economy
- National stock exchange (NSE)
    - It was promoted by prominent financial institutions like IDBI, LIC, UTI, ICICI, SBI and others
    - Come in force 1992 as a tax paying company distinct from other stock exchanges in the country
    - It was the first to offer screen based trading all over India.
    - The capital market segment offers fully automated screen based trading system, known as the National Exchange for Automated Trading system (NEAT)

- Members can simultaneously trade with enormous ease and efficiency by using NEAT system
- NSE internet based information system (NIBIS) provides online dissemination of trading information over the internet.
-
- It is the largest and most modern stock exchange in India
- It establish nationwide trading facility for all types of securities
- It ensure equal access to all investors in the country through an suitable communication network
- It provide a fair , efficient and transparent securities market using electronic trading system
- It enable shorter settlement cycles and book entry settlements
- It meet international benchmarks and standards
- It is nationwide electronic market
- Its popular index is NSE nifty which comprises of 50 stocks which are listed on the NSE
- It offers trading platform for a wide range of products for multiple markets including equity shares, warrants, exchange traded funds (ETF), mutual fund, debt instruments including corporate debt, central and state govt. securities, TB, CP and CD, derivatives etc.

2) Listing of securities
- It is the enrolment of a name of company in an official list maintained by in the stock exchanges
- Creation of ready marketability, liquidity, free negotiability to stock and shares
- Mobilize savings for economic development
- Protect interest of investors by ensuring full disclosure
- Ensure supervision and control of trading

➢ Advantages of listing
- High liquidity
- Helps to know the performance
- Gets regular information
- Tax advantages
- Facilitates buying and selling
- Helps to raise finance
- Protects the investors
- Fair prices
- Good collateral security

➢ Limitations
- Speculation
- No regular price quoting
- Large amount of listing fees
- Information to competitors

➢ Delisting
   a) Voluntary delisting

- Means delisting of securities of a body voluntarily by a promoter or an acquirer or any other person other than the stock exchanges
- The securities of the company have been listed for a minimum period of 3 years on any stock exchange

b) Compulsory delisting

- Delisting of the securities of a company by a stock exchange
- The stock exchanges may also delist companies if the number of shareholders falls below 5 for every rupee 1 lakh capital offered to the public or if the public shareholding falls below 50% of public offer

➢ Trading in stock exchange

a) Auction trading system

- It is also known as order driven trading system
- The trading in securities is done on the floor of the stock exchange on the basis of auction
- This system allows the buyer and seller to find a mutually agreeable price, with no intervention from the broker dealers
- If the buyers and sellers quotations are matched, the transactions are to be carried out

b) Quota driven system

- Under this system transactions take place between a broker and dealer
- The dealers compete with each other to provide the customer the best competitive price.
- It is negotiated market
- The market maker announces two way quotes continuously, one is for buying (bid price) and other is selling price (offer price)

➢ Method of trading in stock exchanges

a) Manual trading

i) Choose brokers

➢ Kinds of brokers

- Commission brokers
- Jobber
- Floor broker
- Odd lit dealer
- Budliwala
- arbitrageur

ii) Opening an account with the broker

iii) Placing the order

iv) Execution of the orders

v) Preparation of the contract notes

vi) Settlement of transactions

vii) Clearing procedures

b) Online security trading

➢ Merits of online trading

- Ensures the best price for investors
- Offer liquidity

- Offer greater transparency
- Enables pester free trading
- Allows quick trading
- Reduce settlement risk
- Access of information

➢ Trading pattern of the indian stock market
  - Spot delivery transactions
  - Forward transactions
  - Transfer and return of certificates
  - Stock index
  - Short selling

Other capital market instruments

➢ Derivatives. Types;
  - Forwards
  - Futures
  - Options
  - Swaps
  - Credit derivatives

➢ Hedge funds

Depository system

- It is an organization, which holds securities of investor in electronic form at the request of the investor through a registered depository participant.
- Securities trading in electronic form
- It is a facility for holding securities, which enables securities transactions to be processed by book entry
- It issues passbook indicating deposits and withdrawal of securities

Re-materialisation

- The investor can withdraw the shares, which are deposited with the depositories
- Investor makes a request for re-materialisation
- Depository participant intimates depository of the request through the system
- Depository confirms re-materialisation request to the registrar
- Registrar updates accounts and prints certificates
- Depository updates accounts and downloads details to depository participant
- Registrar dispatches certificates to investor

Dematerialisation of scrips

It is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited in the investor's account with his DP

Reforms in secondary capital market

1. On line screen based electronic trading system was introduced
2. Measure of corporate governance
3. 3 new stock exchanges at the national level were set up

4. All issuing companies are required to make full disclosure under the listing agreement
5. Stock exchanges, brokers and sub brokers have been brought under the purview of the SEBI
6. Insider trading has been prohibited
7. Internet trading was permitted in FEB 2000
8. Stock brokers are allowed to trade in commodity derivatives
9. FII and NRIs are permitted to invest in all exchange traded derivative contracts
10. No listed companies can issue shares with superior voting rights

<u>Venture capital</u>

- Financing of new ideas and technologies
- Assistance is given to those enterprises where the risk element is comparatively high due to the involvement of technology
- It is a kind of capital requirement which carries more risks and hence only few institutions come forward to finance

➢ Eligibility
  - The project is related with a novel idea or new invention or improved technology or skill
  - It should be capable of commercial exploitation and operation
  - Project is related with a new product, which has good demand prospective
  - It must have attained the pre- production stage

➢ Stages of venture capital financing

1. Early stage
   a) Seed stage
   b) Start up
   c) First stage
2. Expansion stage
   d) Second stage
   e) Third stage
   f) Bridge stage
3. Turn around stage
   g) workout

Module 4

FINANCIAL INSTITUTIONS OR INTERMEDIARIES

Financial intermediaries

- Those organizations which act as intermediaries in financial market
- They act as halfway house between the primary lenders and the final borrowers
- It includes commercial banks, investment companies, insurance companies, non-banking financial companies etc.
- Capital market intermediaries meet the long term financial requirements and money market intermediaries mainly provides short term funds

Types of financial institutions

1. Banking institutions
   a) Organized banking sector
      i. Commercial banks
      ii. Cooperative banks
      iii. Regional rural banks
   b) Non-organized banking sector

Functions of commercial banks

a) Conventional functions
   i. Primary functions
      1. Receiving deposits from the public
         - Fixed deposit accounts
         - Current deposit
         - Savings deposit account
         - Recurring deposit
         - Home safe deposit
      2. Making loans and advances
         - Loans
         - Overdraft
         - Cash credit
         - Discounting of bills of exchange
         - Money at call and short notice
         - Consumer credit
         - Miscellaneous advances
      3. Credit creation
      4. Use of the cheque system and the plastic card
      5. Transfer of funds
   ii. Secondary functions
      1. Agency services
         - Collection of credit instruments
         - Collection of dividends
         - Acts as a trustee or executor
         - Execution of standing orders

- Purchase and sale of securities
- Acting as a representative or correspondent
- Remittance of funds
- Deals foreign exchange
- They act as agents for any govt.
- Acts as an administrator

2. General utility services
   - Safe custody of valuables
   - Locker facility
   - Letter of credit
   - Locker facility
   - Fund transfer
   - Provides information
   - Acts as referees
   - Underwriters shares
   - Issue of gift cheques
   - Foreign exchange
   - Credit cards
   - Travellers cheques
   - Collection of statistics
3. Innovative function
   - Provisions of ATM services to customers
   - Credit card facility
   - Tele banking
   - Personal computer banking or home banking
   - Internet banking
   - Electronic fund transfer system
   - Electronic clearing services
     i. Credit clearing
     ii. Debit clearing
   - Real time gross settlement system (RTGS)
   - Bancassurance
   - Mobile banking
   - Artificial intelligence robots
   - Digital only banks
   - Cloud banking
   - Wearables
   - Biometric technology

Development financial institutions

- Financial agencies that provide medium and long term financial assistance and engaged in promotion and devt of industry, agriculture etc.
- To promote and develop small scale industries
- To finance the development of the housing sector
- To facilitate the devt of large scale industries

- To help the devt of agricultural sector and rural
- To enhance the foreign trade
- To help to review sick industrial units
- To encourage the devt of indian entrepreneurs
- To promote economic activities in backward regions of the country
- To contribution in the growth of capital markets

Objectives of development banks

- Rapid industrial growth
- Encouraging entrepreneurs
- Balanced regional devt.
- Filling gaps
- Helps govt

<u>Development financial institutions in India</u>

- All India financial institutions
- State level institutions
- Term lending institutions
- Refinance institutions
- Sector specific/ specialised institutions
- Investment institutions

<u>Need for development banks</u>

<u>Functions of development banks</u>

- Project finance
- Underwriting of shares
- Direct subscription of equity shares
- Guaranteeing for loans and deferred payments
- Mobilize resources
- Provide technical assistances to prepare, finance and carry out development projects
- Promote institutional infra-structure to accelerate the process of economic devt.
- Train entrepreneurs and professional managers
- Prepare feasibility reports

<u>Industrial Development Bank of India (IDBI)</u>

- It was the apex banking institution in the field of long term industrial finance
- Was set up in July 1964
- It was an autonomous corporation owned by govt of India
- It acted as a project financing institutions
- IDBI is acting as a new generation commercial bank and do all functions performed by a commercial bank

<u>Objectives of IDBI</u>

- To coordinate the activities of the all financial institutions
- To provide term finance to industry
- To provide direct financial assistance to industrial units

- To provide technical and administrative assistance for the promotion expansion and mgt of industrial concerns
- To undertake market and investment research and surveys as also technical and economic studies
- To act as a lender of last resort and to finance projects

Functions of IDBI before 2004

- Direct assistance to large and medium industries
- Indirect finance to tiny, small and medium industries
- Special assistance
- Other assistance

Subsidiaries and joint ventures of IDBI

- IDBI Capital Market Services Ltd (ICMS)
- IDBI Home Finance Ltd
- IDBI Intech Ltd
- IDBI Gilts Ltd
- IDBI Asset Management Ltd (IAML)
- IDBI MF Trustee Company Ltd (IMTCL)
- IDBI Trusteeship Service Ltd (ITSL)
- IDBI Federal Life Insurance Company Ltd

Industrial Finance Corporation of India (IFCI)

- The IFCI is the first development financial institution in India
- Established 1948 under act of parliament.
- Render financial assistance to large scale industrial units
- Its activities include project financing, financial services, merchant banking and investment
- **Functions;** project financing
- Provide financial service including merchant banking and all allied services
- To subscribe shares and debentures of the industrial concerns
- Guaranteeing loan in foreign currency
- Underwriting shares and debentures
- Adopt promotional schemes
- Consultancy fee subsidy scheme
- **Assistance;** the assistance is mainly given to large enterprises (public ltd companies) and cooperatives
- Minimum assistance is rs 2 cr
- Maximum period of loan is 25 years, rate of interest is 14% on loans
- It IFCI is assisting textiles, Chemicals, fertilizers, cement and metal products, and motor glass, rubber and food enterprises
- It has diversifies into a range of other business including broking, venture capital, financial advisory, depository services, factoring etc.
- it has promoted technical consultancy organisations (TCOs) primarily in less developed states

National Bank for Agriculture and Rural Development (NABARD)

- It is an apex development bank for agriculture and rural development.
- Was set up on 12th July 1982
- **Objectives;** to integrate the various institutions involved in the areas of rural development
- to provide guidance in all the matters concerning the formulation and implementation of the rural development programmes
- **roles and duties;** Providing refinance to lending institutions in rural areas
- Bringing about or promoting institutional development
- Evaluating, monitoring and inspecting the client banks
- Act as a coordinator in the operations of rural credit institutions
- Extends assistance to the govt, the RBI 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 govt in reaching their targets of providing assistances to eligible institutions in agriculture and rural development
- Acts as regulator for cooperative banks and RRBs
- **Functions;** it functions as an apex institution. It takes up all functions performed by RBI with regard to rural credit.
- It act as a re-financing agency for institutions which provides production and investment credit to promote various developmental activities related with agriculture, small scale industries, handicrafts etc.
- It provides short term , medium term and long term credit to state co-operative banks, RRBs, commercial banks to promote agricultural and rural development
- It coordinates operations of rural credit agencies
- It provides long term loans to any institutions approved by the central govt.
- It provides facilities for training and research
- **Fund;** the capital of NABARD is held by RBI and govt of India in equal proportion
- It is authorized to raise resources by issue of bonds and debentures guaranteed by the central govt, the World Bank or any other organizations approved by the central govt.
- **Management;** the management vested with board of directors which consists of a deputy manager of the Reserve Bank as the chairman, 3 nominees of the RBI and central govt, 3 members out of which 2 with experience in co-operative banking and 1 in commercial banking, 2 nominees of the state govt, 2 experts in rural economics and rural development, a managing director and one or more whole time directors.
- **Schemes of NABARD;** krishak saathi scheme (KSS)
- Village development plan
- Watershed projects in 31 distressed districts
- Rural infra-structure development fund (RIDF)
- Tribal development fund
- The village development programme (VDP)
- Farmers' club
- Kisan credit card
- Rural innovation fund

The Small Industries Development Bank of India

- It is the principal financial institution for the promotion, financing and development of MSME sector in India
- It is wholly subsidy of IDBI
- It was set up under the separate act of parliament on 2nd April 1990
- **Mission;** To empower the MSME sector with a view to contributing to the process of economic growth, employment generation and balanced regional development
- **Objectives;** to take initiating steps for technological up gradation and modernization of existing units
- To expand the channels of marketing the products of the small scale sector
- To promote employment oriented industries, especially in semi urban areas to create more employment opportunities
- **Functions;** refinancing of terms loans granted by banks and other eligible financial institutions
- Discounting as well as rediscounting of bills
- Provide equity type of assistance under national equity funds and by way of seed capital
- Provide support to services to small scale sector for entrepreneur development
- Provides services like leasing, factoring etc to small scale sector industries
- Extends financial support to national small industries corporation

Export Import bank of India (EXIM bank)

- Was set up in January 1982
- It's a public sector financial institution created by an act of parliament
- Works as the apex banking institution for assisting and supporting developmental activities of such financial institution engaged in foreign trade in India
- Objectives; finance, facilitate and promote foreign trade in India
- To act as a principal financial institution for coordinating the working of institutions engaged in financing export and import trade of India
- To finance indian exports
- Functions; provides financial help for the export or import of goods and services
- Provides financial help for the export and import machinery and equipment on lease
- Financing of joint ventures in foreign countries
- Provides technical, administrative and financial assistance to parties engaged in export-import sectors

Land developmental banks

- Meet the long term credit requirements of agriculturists against security of their land
- It is registered as co-operative society with limited liability

Industrial Reconstruction Corporation of India (IRCI)

The industrial reconstruction bank of India (IRBI)

Industrial investment bank of India (IIBI)

State financial corporations (SFCS)

Infrastructure development finance company ltd (IDFC)

Investment institutions- insurance companies

- Insurance companies provide insurance policies which are legally binding contracts for which the policy holders pays insurance premium
- They evaluate the risk and exposures of potential clients
- They may be classified as ; life insurance companies which sells life insurance, annuities and pensions products
- Non- life, general or property insurance companies cover property against fire and allied perils, flood storm and inundation, earthquake and so on.
- Personal insurance include policies for accidents, health etc.
- Accident and health insurance policies are available for individuals as well as groups
- Liability insurance covers motor third party liability insurance, workmen's compensation policy etc.

Life insurance of India (LIC)

- Owned by the state and has been termed as the biggest life insurance corporation in India now. It is fully owned by the govt. of India
- It was founded in 1956 with the merger of 243 insurance companies and provident societies
- Its headquarters in Mumbai
- It was set up with the objective of spreading life insurance especially in rural areas and to socially and economically backward section of the society
- Objectives: spread the service to all areas
- Maximize mobilization of savings by making insurance linked savings adequately attractive
- Conduct business with utmost economy
- Acts as a trustee of the insured public in their individual and collective capacities
- Meet the various life insurance needs of the community

➢ Whole life policy
  - The plan basically provides for payment of sum assured plus bonuses on the death of the policyholder
  - This policy is suitable for people of all ages who wish to protect their families from financial crises that may occur owing to the policyholder's premature death

➢ The whole life policy-limited payment
  - It enables the life assured to pay all the premiums during the ordinarily and productive years of life
  - He need not pay any premium in the later stages of life if and when his conditions might become adverse.

➢ The whole life policy-single premium

General Insurance Corporation of India (GIC)

- It is the sole reinsurance company in the indian insurance market, registered office situated in Mumbai

- It was formed to control and operate the business of general insurance in India.
- Functions; carrying of any part of the general insurance business as deemed desirable
- Aiding, assisting, and advising the companies in the matter of setting up of standard of conduct and sound practice in general insurance business
- Advising and acquiring companies in the matter of controlling the expenses including the payment of commission and other expenses
- Advising and acquiring companies in the matter of investment of funds
- issuing directions to acquiring companies in relation to the conduct of general insurance business

Unit Trust of India (UTI)

- set up under an act of parliament in 1964
- the trust was established to mobilize the savings of the community by way of sale of its units under its various schemes
- It channelize the mobilized fund into productive investments.
- UTI was set up as a trust without ownership capital and with an independent board of trustees
- The board of trustees manages the affairs and business of UTI
- Objectives; to pool the investible resources
- To enable them to share the benefits and prosperity of the country
- To ensure safety of savings of individuals by diversification of investment
- Functions; to accept discounts, purchase or sell bills of exchange, promissory note etc.
- To grant loans and advances
- To provide merchant banking and investment advisory service
- To provide leasing and hire purchase business
- To extend portfolio mgt service
- To buy or sell or deal in foreign exchange dealings

➢ UTI subsidiaries
  - UTI bank
  - UTI –IAS
  - UTI investors service ltd
  - UTI institute of capital market
  - UTI security exchange ltd

Mutual funds

- It is the trust that pool the savings of a number of investors who share common financial goal.
- It collects the savings from the small investors, invest them in govt and other corporate securities and earn income through interest and dividend, besides capital gains.
- Each fund is divided into equal portions or units. Units are allotted to the persons in proportion of his investment in mutual fund.
- It is the collection of stocks and bonds
- Savings of investors are collected and these funds are invested in a large and well diversified portfolio of securities such as money market instruments, corporate and govt bonds and equity shares of joint stock companies

- It is financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective

➢ Advantages
- Easy access to invest
- Portfolio diversification
- Increased diversification
- Liquidity
- Professional investment
- Economies of scale
- Minimum initial investment
- Risk reduction
- Convenience and fair pricing
- Affordability
- Reduction in transactions cost
- Tax benefits
- Transparency

➢ Disadvantages
- No guarantees
- The diversification penalty
- Costs
- High expense ratios and sales charges
- Tax inefficiency
- Mutual funds lack liquidity
- Fluctuating returns
- Misleading advertisements
- Evaluating funds

➢ Types of mutual funds
- By structure;
  a. Open ended scheme
     1. Stock funds
        i. Large cap
        ii. Mid cap
        iii. Small cap
        iv. international
     2. Bond funds
        i. Tax free
        ii. taxable
     3. Money market funds
        i. Tax free
        ii. Taxable
     4. Actively managed fund
     5. Index fund
  b. Interval scheme
  c. Close ended scheme
- By investment objective

1. Growth scheme
2. Income scheme
3. Balanced scheme
4. Money market scheme

- Other schemes
  1. Tax saving schemes
  2. Index schemes
  3. Sector specific schemes
  4. equity funds
  5. income/debt oriented schemes
     i. Gilt funds
     ii. Income funds
     iii. MIPs
     iv. Short term plans
     v. Liquid funds

➢ Arbitrage fund
- An arbitrage fund buys equities in the cash market and simultaneously sells in the future market
- It is a unique asset class by itself where returns are generated by capturing the pricing differential between the cash and the future markets

<u>Other types of mutual fund investments</u>

➢ Exchange traded funds (ETFS)
- New variety of mutual funds introduced in 1993, which sometimes described as "tax efficient"
- Some large ETFs have made smaller distribution of realized and taxable capital gains than most mutual funds
- These are the mutual funds that are listed and traded on exchanges like stock.
- Its trading value based on the net asset value of the assets it represents
- Generally, ETFs invest in a basket of stocks and try to imitate a stock market index such as the S&P CNX Nifty or BSE Sensex, a market sector such as energy or technology, or a commodity such as gold or petroleum

➢ Gold exchange traded schemes
➢ Gold deposit scheme (GDS)
➢ Maturity plans
➢ Monthly income plans
➢ Asset allocation funds

<u>Infrastructure debt fund scheme</u>

It is a mutual fund scheme that invests primarily (minimum 90% of scheme assets) in the debt securities or securitized debt instrument of infrastructure companies or infrastructure capital companies or infrastructure projects or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure

<u>Private placement</u>

The units of an infrastructure debt fund scheme may be offered through private placement to less than 50 persons, subject to approval by the trustees and the board of asset Mgt Company

UTI and private sector mutual funds

- UTI was created by the act passed by the parliament in 1963
- UTI launched its first scheme in 1964, named as unit scheme 1964 (US-64)
- UTI was set up as a trust without ownership capital and with an independent board of trustees. The board of trustees manages the affairs and business of UTI
- The board performs its functions, keeping a view the interest of the unit holders under various schemes
- The adoption of changes in policies of the govt of India in 1991 opened the way to private sectors to enter in the field of mutual funds. The permission was given to private sector funds including foreign fund mgt companies to enter the mutual fund industry in 1993
- UTI was recognized into two parts; the specified undertaking, and The UTI mutual fund

Development of mutual funds in India

- first phase -1964-87
- second phase 1987-1993 (entry of public sector funds)
- third phase -1993-2003 (entry of private sector funds)
- fourth phase –since February 2003

➢ structure of mutual fund industry
  - sponsors, who initiate the idea to set up a mutual fund and arrange capital
  - trustees, enter into a mgt agreement with the AMC to manage the money collected through various schemes
  - And asset management company (AMC), takes investment decisions, maintains proper accounting and information, calculates the NAV and provides all relevant information.

➢ Major mutual fund companies in India
  ABN AMRO Mutual fund, Birla sun life mutual fund, bank of Baroda mutual fund, HDFC mutual fund etc.

➢ Regulatory authorities
  - The working of the mutual funds is governed by UTI act 1963, Indian trust act 1882, relevant provisions of the companies' act 1956, and securities contract act 1956 and various tax laws.
  - Mutual funds in India are governed by the SEBI (mutual fund) regulations 1996 as amended from time to time.

➢ Benefits of mutual funds
  - Risk diversification
  - Liquidity
  - Conveniences
  - Expert management
  - Encourages new investors

➢ Problems of mutual funds in India
  - Conservative pattern of investment
  - No innovative schemes
  - Problems of liquidity
  - Insufficient research
  - Inadequate disclosure
  - Service delay
  - Poor risk management

- No rural base

Non- banking financial intermediaries

- These are the varied financial segment of institutions, other than commercial and cooperative banks.
- It includes a larger number of financial institutions which raises deposits, from the public directly or indirectly and lends money
- They are; development banks like IDBI, IFCI,ICICI, and SFCS
- UTI
- Provident funds and post offices
- Other investment companies like finance companies, hire purchase finance companies, lease financing, housing finance companies etc.

➢ Non- banking financial institutions in India

- IFCI
- NIDC
- ICICI

➢ Exim bank

- Was set up in January 1982
- It is a public sector financial institutions created by an act of parliament viz, export and import bank of India act 1981
- It works as the apex banking institution for assisting and supporting developmental activities of such financial institutions which are engaged in the field of foreign trade in India

➢ Objectives

- To finance, facilitate and promote foreign trade in India
- To act as a principal financial institution for coordinating the working of institutions engaged in export and import trade of India
- To finance indian export

➢ Technical consultancy organizations

➢ Ware housing co-operations

Lease financing

- Important source of funds to support business expenditure for capital equipment
- Types; operating lease and financial lease
- Participants; producer of the capital equipment, the buyer of the capital equipment, and a leasing company

Factoring service

- It is a financial institution which manages the collection of accounts receivables of business firm, and bears the credit risk associated with it
- In resource factoring, the factor doesn't take on the risk of bad debts. They will be able to reclaim their money from the client even if the customer doesn't pay
- In non-resource factoring, the factor takes on the bad debts risk

Forfaiting

- it is an established method of providing fixed rate trade finance for exports transactions

- it is the purchase of a series of credit instruments such as drafts drawn under time letters of credit, bills of exchange, promissory notes or other freely negotiable instruments on a non-recourse basis

➢ difference between forfaiting and factoring

forfaiting	**factoring**
it is for export of capital goods on medium and long term basis	it is finance for short term trade
It is 100% financing without recourse	It can be with course and without course
Complete ledger of exporter is not transferred to forfeiter	Factor handles the entire sales ledger at a predetermined price
The exporter sells the export bill to the forfeiter for cash	Factor undertakes to collect the debt assigned by exporters
The importers bank provides guarantee	Such guarantee is not usually stipulated

Module 5

REGULATORY INSTITUTIONS

Regulators of financial system

a. RBI-Reserve Bank of India
b. SEBI- Security Exchange Board of India

The Reserve Bank of India (RBI)

- Our central bank was established in 1935
- Prior to central bank Imperial bank performed some of the central banking functions
- Imperial bank was established in 1921 by way of amalgamating 3 presidency banks of Madras, Bengal and Bombay
- The Hilton commission recommended the establishment of central bank
- In 1931, the central bank enquiry committee recommended to start a central bank
- The assembly passed the Reserve Bank of India Act in 1934 and Reserve Bank of India started its operations in 1935
- RBI regulates and prohibits the issue of prospectus or advertisement soliciting deposits of money, regulates the functioning of non- banking institutions and transacts govt business
- Its regulatory involvement in the indian capital markets is primarily of debt mgt through primary dealers, foreign exchange control and liquidity support to market participants
- The RBI regulates participants in the securities markets when a foreign transaction is involved
- A transaction which includes indian issuers issuing of security outside India, such as GDRs and ADRs and financial institutional investors (FIIs) or foreign Brokers selling, buying or dealing in indian securities need the permission of RBI

➢ Objectives
  - It is the authority to regulate and control the monetary system of our country
  - It have an authority to control money market
  - It has given the power to pursue an appropriate credit policy
  - To regulate the banking system of our country

➢ Organisation
  - It was originally organized as shareholder's bank with a paid share capital of rs 5 crores divided into 5 lakhs shares of rs 100 each
  - Out of this, shares of rs 230000 were allotted to central govt for disposal at par to directors of the central board of bank seeking to obtain the minimum share qualification
  - Private individuals own the balance of share capital
  - The RBI was nationalized in the year 1948 by way of passing The Reserve Bank of India act in 1948
  - The RBI started functioning as a state owned and state controlled central bank from 1st January onwards
  - The authorized, subscribed and paid share capital of RBI is rs 5 crores

➢ Management
  - Central board

- Local board

➢ Functions of RBI

a. Monetary functions
   - Monopoly of note issue
   - Banker to the govt
     - As a banker
     - As a financial advisor
     - As financial agent
   - Bankers bank and lender of the last resort
   - Acts as clearing house
   - Controller of credit

b. Quantitative credit control weapons
   - Bank rate policy
   - Open market operations
     - Stability of cash price in banks
     - Existence of unorganized sector
     - Strengthening of the security market
     - Development of institutional structure
   - Variable cash reserve ratio (CRR)
   - Statutory liquidity Ratio (SLR)

c. Selective credit control (qualitative credit control)
   - Issuing directives
   - Regulation of margin requirements
   - Differential rates of interest
   - Restriction on clean advances
   - Credit authorization scheme
   - Loan system for delivery of bank credit
   - Moral suasion and credit rationing
   - Direct action
   - Control of foreign exchange operations

d. Non- monetary functions
   - Supervisory functions
   - Promotional functions

Evolving role of the Reserve bank of India- recent developments

- Rapid reforms in central banking law and governance in the last about two decades imparted some autonomy to the central bank, particularly in the areas of monetary mgt and financial regulation
- A board for financial supervision (BFS), a committee of the central board of RBI was set up in 1994 and meets at least once a month to guide and oversea the RBI’s supervisory functions
- The BFS includes four independent members drawn from the central Board of Directors of RBI with relevant professional background and experience
- A notable legislative measure in the recent past relates to greater flexibility to RBI in regard to cash reserve requirements, deployment of forex reserves, and clarity in regulation over money, forex and govt securities markets

- The RBI has also been entrusted with the work relating to banking and supervision by an enactment in 1949

Securities and exchange Board of India (SEBI)

- Stock exchanges in India were continued to be regulated directly by the govt of India under powers conferred in terms of the securities contract act 1956
- The SEBI was established on April 12, 1988 through an administrative order.
- It became a statutory and really a powerful organisation only in 1992 when the controller of capital issues was abolished
- It was constituted by the govt of India as a non – statutory body to promote the developments of the security markets and to provide adequate investor protection and act as the independent regulator of stock exchanges, the primary market, mutual funds etc.
- Its head office is in Mumbai, it has three regional offices in new Delhi, Calcutta and Chennai

➢ Reasons to form SEBI:

- manipulation of security prices
- Price rigging
- Insider trading
- Delay
- Lack of fair dealings
- Protection of investors
- Lack of control over brokers

➢ Objectives of SEBI

- To protect the interest of investors
- Ensure fair practices by the issuers of securities
- Promotion of efficient services by brokers, merchant bankers etc.

➢ Functions of SEBI

- Protect the interest of the investors in securities and to promote, develop and to regulate the securities market
- Regulating the business in stock exchanges
- Registering and regulating the working of stock brokers, sub brokers etc
- Registering and regulating the working of the depositories, participants etc
- Promoting and regulating self -regulatory organizations
- Prohibiting fraudulent and unfair trade practices relating to securities markets
- Promoting investor's education and training of intermediaries of securities markets
- Prohibiting insider trading in securities
- Levying fees or other charges

➢ Powers

- Call for periodical returns from the stock exchanges
- Call any explanation or information relating to the affairs of the exchange
- To compel public companies to list their shares
- Prohibit contract in certain cases
- Withdrawal of recognition of stock exchanges
- Power to grant registration to intermediaries

- To suspend the business of a recognized stock exchange

- Organization structure of SEBI
  - A chairman
  - Two members from amongst the officials of ministries of the central govt dealing with finance and law
  - One member from amongst the officials of the RBI
  - Two other members appointed by the central govt who are special knowledge relating to the security market
- General superintendence
- Departments
  - The primary market department
  - The secondary market department
  - Issue mgt and intermediary dept.
  - IIMARP dept.
  - The legal department
  - The investigation department
- SEBI guidelines
  - Protection to the investor
  - New issue
  - Directions
  - Other important measures
  - Investors' education
  - Quick reference
  - Grievances
  - Investor's information centre
  - Prohibition of fraudulent and unfair trade practices
  - Inspections and enforcements
  - Insider trading
  - stocks invest
- guidelines by SEBI regarding right issue
  - right issue should not be kept open for at least 60 days
  - right issue must be kept open for at least 30 days
  - reservation is not allowed on right issues
  - right issue can only be in respect of fully paid shares
  - letter offer shall contain disclosure as per SEBI requirements
- SEBI guidelines on bonus issue
  - no bonus shares shall dilute other issues
  - bonus issue from free reserves
  - revaluation reserve not eligible
  - issue in lieu of dividend
  - partly paid shares not eligible
  - no default of payment of interest
  - increase in authorized capital
  - provision in the articles
- SEBI guidelines for issue of fresh share capital

- All applications should be submitted to SEBI in the prescribed form
- Applications should be accompanied by true copies of industrial licence
- Cost of the project should be furnished with scheme of finance
- An equity preference ratio of 3:1is allowed
- All the details of the underwriting agreement
- Allotment of shares to NRIs is not allowed without the approval of RBI
- Details of any firm allotment in favour of any financial institutions
- Declaration by secretary or director of the company

➢ SEBI guidelines for first issue by new companies in primary market
  - a new company which has not completed 12 months of commercial operations will not be allowed to issue shares at a premium
  - if an existing company with a 5 year track record of consistent profitability is promoting a new company, then it is allowed to price its issue
  - a draft of the prospectus has to be given to the SEBI before public issue
  - in case of an IPO, the public issue by unlisted company, the promoters have to necessarily offer at least 20% of the post issue capital

➢ SEBI guidelines foe secondary market
  - all the companies entering the capital market should give a statement regarding fund utilizing of previous issue
  - brokers are to satisfy capital adequacy norms so that the member firms maintain adequate capital in relation to outstanding positions
  - the stock exchange authorities have to alter their bye laws with regard ac capital adequacy norms
  - all the brokers should submit with SEBI their audited accounts
  - the brokers must also disclose clearly the transaction price of securities and the commission earned by them
  - the brokers should issue within 24 hours of the transaction contract notes to the clients
  - the brokers must clearly mention their accounts details of funds belonging to clients and that of their own
  - margin money on certain securities has to be paid by claims so that speculative investments are prevented
  - a broker cannot underwrite more than 5% of the public issue
  - all transactions in the market must be reported within 24 hours to SEBI

➢ Recent trends and reforms in primary capital market
  - The SEBI was set up in early 1988. In January 1992 statutory powers were given to SEBI to regulate securities market through enactment of SEBI act 1992. the two objectives are investors protection and orderly development of capital market
  - In May 1992 the capital issues act was cancelled. The issuers of securities are allowed to raise capital without the consent of any authority. Restrictions on right and bonus shares were also removed. the interest rate of debentures also freed
  - large number of merchant bankers, investment and consulting agencies and registrars to issue are set up over ears
  - in 1990 mutual funds were set up in the private sector
  - the requirements to issue shares at par value of 10 and 100 was withdrawn
  - SEBI has permitted companies to determine the par value of shares issued by them

- instruction of improved disclosure standards, prudential norms and simplifies issue procedures
- companies are allowed to invest all GDR/ADR proceeds in foreign countries
- certain mandatory conditions related to infrastructural companies are removed
- only body corporate to be allowed to function as merchant bankers
- SEBI has allowed companies to provide discount of up 10% to retail investors in public offers
- now PAN has been mandatory in all public and right issues irrespective of the application amount

➢ measures taken by SEBI to strengthen primary market
- strengthening of disclosure requirements and eligibility criteria
- material disclosure

➢ measures taken by SEBI to develop secondary securities market
- introduction of depositories and paperless trading
- strengthening the safety and integrity of the secondary securities market
  i. intra-day trading and exposure limits
  ii. setting up of trade/ settlement guarantee fund by stock exchanges
  iii. rationalization of margin system/ market safety
  iv. rationalization of risk mgt system for the equity market
- enhancing efficiency and transparency in the stock exchanges
  i. modified carry forward system
  ii. uniform settlement cycle
  iii. rolling settlement
  iv. inter connectivity between NSDL and CDSL
- To ensure financial viability
- to increase the business opportunities for brokers and exchanges
- trade in securities by qualified participants
- negotiated deals
- market making
- new products and procedures
  i. the securities lending scheme
  ii. committee on corporate governance
  iii. foreign institutional investors
  iv. internet based securities trading
  v. screen based trading

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