KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)
(Established under section 3 of UGC Act 1956)
Coimbatore-641021

DEPARTMENT OF MANAGEMENT

Subject: **Financial Services Management**
Semester: **III**
Subject Code: **17MBAPF303C** **Class- II MBA**

SCOPE

As finance personnel one should understand various ways of generating funds in to an organization and should also know ways and means of investing surplus.

OBJECTIVES

- To understand the regulation of merchant banking.
- To know about mutual funds and the concept of factoring.
- To manage hire purchase and investment..

UNIT I

Nature and scope of Merchant Banking – Regulation of Merchant Banking – Overview of Current Indian Merchant Banking Scenario – Problems faced by financial services sector in India - Procedural aspects of primary issue – Pre-issue Decision Making – Post Issue Management.

UNIT II

Mutual Funds – Operation – Performance of mutual funds in India – SEBI guidance for Mutual Funds Securitization – Concept, Securitization as a Funding Mechanism, Securitization of Residential Real Estate – Mortgages and Mortgage Investments.

UNIT III

Factoring – Forms of Factoring Vs Bill Discounting – Factoring Vs Credit Financing – Factoring Vs Forfeiting – Forfeiting in Indian Scenario - Evaluation of a Factor – Legal aspects of Factoring – Factoring Services in India – Bill of Exchange – Definition – Features.

UNIT IV

Leasing – History and Development – Concept and Classification – Types – Advantages – Disadvantages - Legislative Framework – Supplier, Lessor, Lessee Relationship – Sub Lease – Default and Remedies – Lease Evaluation in Lessee‘s and Lessor‘s point of view.

UNIT V

Hire Purchase – Concept and Characteristics – Rate of Interest – Methods of reporting adopted for hire purchase transactions - Legal aspects – Tax implication frame work for Financial Evaluation – Credit Rating – Concept – Types – Advantages and Disadvantages – Process–Agencies.

SUGGESTED READINGS:

TEXT BOOKS

1. Khan, M.Y. (2015). *Financial Services* (7th edition). New Delhi: Tata McGraw Hill.
2. Ramesh Babu, G. (2015). *Indian Financial System.* New Delhi: Himalaya Publishing House

REFERENCES

1. Shanmugam, R. (2010). *Financial Services*. New Delhi: Wiley India Pvt Ltd.
2. Gurusamy, S. (2009). *Merchant Banking and Financial Services* (3rd edition). New Delhi: Tata Mc Graw Hill Education Pvt Ltd.
3. Gordon, E. Natarajan. (2013). *Financial Markets & Services*. New Delhi: Himalaya Publications.

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)
(Established under section 3 of UGC Act 1956)
Coimbatore-641021

DEPARTMENT OF MANAGEMENT

Name: **PADMAAVATHY.PA (Assistant Professor)**
Department: **Management**
Subject Code: **17MBAPF303C** Semester: **III** Year: **2017-19 Batch**
Subject: **Financial Services Management- Lesson Plan**

UNIT - 1			
S. No	**Lecture Hours**	**Contents**	**References**
1.	1	Nature and scope of Merchant Banking	T1: PgNo.: 11.1
2.	1	Regulation of Merchant Banking	T1: PgNo.: 11.1
3.	1	Overview of Current Indian Merchant Banking Scenario	T1: PgNo.: 11.1
4.	1	Problems faced by financial services sector in India	W1
5.	1	Procedural aspects of primary issue	T2:PgNo.:11.15
6.	1	Pre-issue Decision Making	T2:PgNo.:11.15
7.	1	Post Issue Management	T2:PgNo.:11.15
8.	1	Case Study	-
9.	1	Recapitulation and Discussion of Important Questions	-
Total no. of Hours planned for Unit 1			**9**
UNIT - 2			
1.	1	Mutual Funds	T1: PgNo.: 15.19
2.	1	Operation – Performance of mutual funds in India.	T1: PgNo.: 15.19
3.	1	SEBI guidance for Mutual Funds	T1: PgNo.: 17.23
4.	1	Securitization – Concept	T1: PgNo.: 8.53
5.	1	Securitization as a Funding Mechanism	T1: PgNo.: 8.59
6.	1	Securitization of Residential Real Estate	T1: PgNo.: 8.59
7.	1	Mortgages and Mortgage Investments	T1: PgNo.: 8.69
8.	1	Case Study	-
9.	1	Recapitulation and Discussion of Important Questions	
Total no. of Hours planned for Unit 2			**9**
UNIT - 3			
1.	1	Factoring	T1: PgNo.: 6.1
2.	1	Forms of Factoring Vs Bill Discounting	T1: PgNo.: 7.1
3.	1	Factoring Vs Credit Financing	T1: PgNo.: 7.15
4.	1	Factoring Vs Forfeiting	T1: PgNo.: 6.11
5.	1	Forfeiting in Indian Scenario	T1: PgNo.: 6.12
6.	1	Evaluation of a Factor, Legal aspects of Factoring, Factoring Services in India	T1: PgNo.: 6.15,6.18
7.	1	Bill of Exchange – Definition – Features	T1: PgNo.: 6.22

8.	1	Case Study	-
9	1	Recapitulation & Discussion on important questions	-
Total number of hours planned for Unit 3			**9**
UNIT - 4			
1.	1	Leasing – History and Development	T1: PgNo.: 2.3
2.	1	Concept and Classification	T1: PgNo.: 2.4
3.	1	Types	T1: PgNo.: 2.5
4.	1	Advantages – Disadvantages	T1: PgNo.: 2.6
5.	1	Legislative Framework	T1: PgNo.: 2.23
6.	1	Supplier, Lessor, Lessee Relationship	T1: PgNo.: 4.1
7.	1	Sub Lease – Default and Remedies , Lease Evaluation in Lessee‘s and Lessor‘s point of view	T1: PgNo.: 4.7
8.	1	Case Study	-
9.	1	Recapitulation and Discussion of Important Questions	-
Total no. of Hours planned for Unit 4			**9**
UNIT - 5			
1.	1	HirePurchase–Conceptand Characteristics	T1: PgNo.: 5.14
2.	1	Rate of Interest	T1: PgNo.: 5.16
3.	1	Methods of reporting adopted for hire purchase transactions	T1: PgNo.: 5.18
4.	1	Legal aspects	T1: PgNo.: 5.20
5.	1	Tax implication frame work for Financial Evaluation.	T1: PgNo.: 5.22
6.	1	Credit Rating – Concept – Types	T1: PgNo.: 16.1
7.	1	Advantages and Disadvantages , Process–Agencies	T1: PgNo.:16.5.8
8.	1	Case Study	
9	1	Recapitulation & Discussion on important questions	-
10	1	Revision of previous year question paper	-
11	1	Revision of previous year question paper	-
12	1	Revision of previous year question paper	-
Total no. of Hours planned for Unit 5			**12**

Suggested Readings:

Text Books:

T1: Khan, M.Y. (2015). *Financial Services* (7th edition). New Delhi: Tata McGraw Hill
T2: Ramesh Babu, G. (2015). *Indian Financial System.* New Delhi: Himalaya Publishing House.

Reference Books:

R1: Shanmugam, R. (2010). *Financial Services*. New Delhi: Wiley India Pvt Ltd**.** .

Journals:

J1. . Prabandhan - Indian Journal of Management

Websites:

W1. http://humanresources.about.com

W2: https://www.mutualfundindia.com/Home/MfBasics.

W3: https://efinancemanagement.com › Sources of Finance

W4: www.yourarticlelibrary.com/financial-management/lease-financing-types.../43833

W5: www.accaglobal.com/in/en/business-finance/types-finance/hire-purchase.html

UNIT-I- NATURE AND SCOPE OF MERCHANT BANKING

SYLLABUS

Unit I
Nature and scope of Merchant Banking – Regulation of Merchant Banking – overview of Current Indian Merchant Banking Scenario – Procedural aspects of primary issue – Pre-issues Decision Making – Post Issue Management..

Meaning of Merchant Banking

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 merchant not banks.

In India merchant banking services were started only in 1967 by National Grind Lays 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 organisation which provides a number of services including management of securities issues, portfolio services, underwriting of capital issues, insurance, credit syndication, financial advices, project counselling 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 individuals.

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 allied functions also.

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 approvals and incentives, etc. Some of the merchant banks also 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 usually act as sponsor of issues.

They obtain consent of the Controller 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 also provide flexibility and freedom to the issuing companies.

3. Credit Syndication:

Merchant banks provide specialised services in preparation of project, loan applications for raising short-term as well as long- term credit from various bank and financial institutions, etc. They also 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 also to the investors. They advise their clients, mostly institutional investors, regarding investment decisions. Merchant bankers even undertake the function of purchase and sale of securities for their clients so as to provide them portfolio management services. Some merchant bankers are operating mutual funds and off shore funds also.

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 also help companies in raising finance by way of public deposits.

6. Servicing of Issues:

Merchant banks have also 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 Specialised Services:

In addition to the basic activities involving marketing of securities, merchant banks also 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 also started making of bought out deals of shares and debentures. The activities of the merchant bankers are increase with the change in the money market.

Merchant Banking Regulations:

SEBI (Merchant Bankers') Regulation Act, 1992 defines a 'merchant banker' as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management".

At present no organisation can act as a 'merchant banker' without obtaining a certificate of registration from the SEBI.

However, it must be noted that a person/ organisation has to get himself registered under these regulations if he wants to carry on or undertake any of the authorised activities, i.e., issue management assignment as manager, consultant, advisor, underwriter or portfolio manager.

To obtain the certificate of registration, one had to apply in the prescribed form and fulfil two sets of norms (i) operational capabilities and (ii) capital adequacy norms.

Classification of Merchant Bankers:

The SEBI has classified 'merchant bankers' under four categories for the purpose of registration:

1. Category I Merchant Bankers:

These merchant bankers can act as issue manager, advisor, consultant, underwriter and portfolio manager.

2. Category II Merchant Bankers:

Such merchant bankers can act as advisor, consultant, underwriter and portfolio manager. They cannot act as issue manager of their own but can act co-manager.

3. Category III Merchant Bankers:

They are allowed to act as underwriter, advisor and consultant only. They can neither undertake issue management of their own nor they act as co-manager. They cannot undertake the activities of portfolio management also.

4. Category IV Merchant Bankers:

A category IV merchant banker can merely act as consultant or advisor to an issue of capital.

Capital Adequacy Norms:

SEBI has prescribed capital adequacy norms for registration of the various categories of merchant bankers. The capital adequacy is expressed in terms of minimum net worth, i.e., capital contributed to the business plus free reserves.

The following are the capital adequacy norms as laid down by SEBI:

Capital Adequacy Norms

Category of Merchant Bankers	*Minimum Net Worth*
Category I	₹ 5 crore
Category II	₹ 50 lakhs
Category III	₹ 20 lakhs
Category IV	Nil

Fees:

According to the SEBI (Merchant Bankers) Amendment Regulations, 1999, i.e. 30.9.1999, every merchant banker shall pay a sum of Rs. 5 lakhs as registration fees at the time of grant of certificate by the Board. The fee shall be paid by the merchant banker within 15 days of receipt of intimation from the Board.

Further, a merchant banker to keep registration in force shall pay renewal fee of Rs. 2.5 lakhs every three years from the fourth year from the date of initial registration.

Government Policy for Merchant Banking:

The Government issued policy guidelines for merchant bankers to ensure sufficient physical infrastructure, necessary expertise, good financial standing, professional integrity and fairness in their transactions. The merchant bankers have to be competent to serve the investors also.

On 1st March, 1993 new policy guidelines have been issued by SEBI for the merchant bankers to ensure greater transparency in their operations and to make them accountable so as to protect the investor's interest. The guidelines relate to pre-issue obligations, underwriting, advertisements and post-issue obligations of the merchant bankers.

Merchant banks found its origin in the early periods in the country of Italy by the Italian merchants. The main function of the merchant banking services include providing financial JN0-522advice and services to corporate as well as individuals. These banks act as a sort of intermediary between capital issuers and the buyers of the securities. These securities are issued by different companies in the stock markets to raise funds.

The Necessity of Merchant Banking Services

The economy of the country is often afflicted with different unpredictable conditions like inflation, unemployment, stagnation and so forth. The need to sustain a steady growth is necessary for corporations and individuals which is possible only with a long term strategy and financial options. The merchant banking services provide solutions and financial options.

These banks provide advisor services to clients based on a particular fee. They also provide other financial services to mergers and clients. It is the only financial institute that invests its capital in the clients' company. It acts as an intermediary between those who possess capital and those who need capital.

To help their clients with a number of financial options, the merchant banking services operate in a number of countries all over the world. In this manner the clients have the opportunity to survey the different financial options to ensure better growth. Functions of the Merchant Banking Services

These banks have a number of functions and some of the most important among them include:

Raise funds:

Offer advisory services:

Security distribution:

Aid in projects:

Overall financial reconstruction:

Offer advice on management of risks:

Today the merchant banking services provide a number of other services like loan syndication, credit acceptance, counselling of mergers and acquisitions, management of portfolio and so forth. They also assist companies with short term liquidity funds. In a nutshell, these banking services are indispensable as they support individuals and corporate to expand their business ventures.

Conformance to Requirements

Subject to the provisions of the regulations, any application, which is not complete in all respects and does not conform to the instructions specified in the form, shall be rejected.

Furnishing of Information

The Board may require the applicant to furnish further information or clarification regarding matters relevant to the activity of a merchant banker for the purpose of disposal of the application.

Consideration of Application

The Board shall take into account for considering the grant of a certificate, all matters, which are relevant to the activities relating to merchant banker and in particular whether the applicant complied with the following requirement.

1. That the applicant shall be a body corporate other than a non-banking financial company as defined under clause (f) of section 45-I of the Reserve Bank of India Act, (2 of 1934) as amended from time to time;

2. That the merchant banker who has been granted registration by the Reserve Bank of India to act as a primary or Satellite Dealer may carry on such activity subject to the condition that it shall not accept or hold public deposit;

3. That the applicant has the necessary infrastructure like adequate office space, equipment's, and manpower to effectively discharge his activities;

4. That the applicant has in his employment minimum of two persons who have the experience to conduct the business of the merchant banker;

5. That the applicant fulfils the capital adequacy requirement as specified in the relevant;

6. That the applicant is a fit and proper person; and

7. That the grant of certificate to the applicant is in the interest of investors.

Capital Adequacy Requirement

According to the regulations, the capital adequacy requirement shall not be less than the net worth of the person making the application for grant of registration.

Procedure for Registration

The Board on being satisfied that the applicant is eligible shall grant a certificate in Form B. On the grant of certificate, the applicant shall be liable to pay the fees in accordance with Schedule II

Renewal of Certificate

Three months before expiry of the period of certificate, the merchant banker, may if he so desires, make an application for renewal in form A. The application for renewal shall be dealt with in the same manner as if it were a fresh application for grant of a certificate. On the grant of a certificate the applicant shall be liable to pay the fees in accordance with Schedule II.

Procedure where registration is not granted

Where an application for grant of a certificate under regulation 3 or of renewal under regulation 9, does not satisfy the criteria set out in regulation 6, the Board may reject the application after giving an opportunity being heard. The refusal to grant registration shall be communicated by the Board within thirty days of such refusal to the applicant stating therein the grounds on which the application has been rejected.

THE ACTIVITIES INVOLVED IN PUBLIC ISSUE MANAGEMENT

Activities involved in Public Issue Management

There are several activities that have to be performed by the issue manager in order to raise money from the capital market. Adequate planning needs to be done while chalking out an appropriate marketing strategy. The various activities involved in raising funds from the capital markets are described below:

Pre-issue Activities

1. **Signing of Memorandum of Understanding (MOU):** Signing of MOU between the client company and the merchant banker-issue management activities, marks the award of the contract. The role and responsibility of the merchant banker as against the issuing company are clearly spelt out in the MOU.

2. **Obtaining appraisal note**: An appraisal note containing the details of the proposed capital outlay of the project and the sources of funding is either prepared in-house or is obtained from external appraising agencies, viz, financial institutions/banks, etc.

3. **Optimum capital structure**: The level of capital that would maximize the shareholder's vale and minimize the overall cost of capital has to be determined.

4. **Convening Meeting**: A meeting of the Board of Directors of the issuing company is convened. This is followed by an EGM of its members.

5. **Appointment of financial intermediary**: Financial intermediaries such as Underwriters, registrars, etc. have to be appointed. Necessary contracts need to be made with the underwriter to ensure due subscription to the offer. Similar contracts, when entered into with the Registrars to an issued, will help in share allotment related work.

6. **Preparing documents**: As part of the issue management procedure, the documents to be prepared are initial listing application for submission to those stock exchanges where the issuing company intends to get its securities listed, MOU with the registrar, with bankers to the issue, with advisors to the issue and co-managers to the issue, agreement for purchase or properties, etc.

7. **Due diligence certificate**: The lead manager issues a 'due diligence certificate' which certifies that the company has scrupulously following all legal requirements, has exercised utmost

care while preparing the offer document and has made a true, fair and adequate disclosure in the draft offer document.

8. **Submission of offer document**: The draft offer document along with the due diligence certificate is filed with SEBI. The SEBI, in turn, makes necessary corrections in the offer document and returns the same with relevant observations, if any, within 21 days from the receipt of the offer document.

9. **Finalization of collection centres**: In order to collect the issue application forms from the prospective investors, the lead manager finalizes the collection centres.

10. **Filing with ROC**: The offer document, completed in all respects after incorporating SEBI observations, is filed with Registrar of Companies (ROC) to obtain acknowledgement.

11. **Launching the issue**: The process of marketing the issue starts once the legal formalities are completed and statutory permission for issue of capital is obtained. The lead manager has to arrange for the distribution of public issue stationery to various collecting banks, brokers, investors, etc. the issue is opened for public immediately after obtaining the observation letter from SEBI, which is valid for a period of 365 days from the date of issue.

12. **Promoters' contribution**: a certificate to the effect that the required contribution of the promoters has been raised before opening of the issue, has to be obtained from a Chartered Accountant, and duly filed with SEBI.

13. **Issue closure**: An announcement regarding the closure of the issue should be made in the newspapers. and same to sent to the SEBI and the regional stock exchange.

POSSIBLE QUESTIONS

PART – A (ONE Mark)
Multiple Choice Questions
Online Examination

PART –B

1. Write short notes on recent developments in Merchant Banking
2. What are various categories of merchant banking?
3. Explain the functions of merchant bankers.
4. What is the meaning of merchant banking?
5. List the pre-issue activities in issue management

PART –C

1. Draw up the classification of Merchant Bankers as laid down by SEBI.
2. Narrate the problems of Merchant Bankers
3. Bring out in detail the various code of conduct followed by Merchant Bankers
4. Narrate the Pre issue obligations of a Merchant Banker
5. Enumerate the various qualities required for a Merchant Banker?
6. Comment on any five guidelines issued by SEBI for Merchant Bankers.
7. Evaluate various procedural aspect to be followed by Merchant Bankers.
8. Discuss the various functions of Merchant Bankers.
9. Discuss the growth of Merchant Banking business in India
10. Evaluate the various services of Merchant Banks operating in India.

PART –D

Comarch Corporate Banking for TMB Bank

Originally, the main objective of the project was to augment the existing set of products and services offered by the bank via internet channel by introducing a new internet banking system for business clients, covering the areas of cash management, trade finance and lending.The platform to be delivered had to be secure, and all of the services and products had to be accessible seamlessly using single sign-on mechanism. Furthermore, the solution had to provide excellent user experience for the clients.

During the life of the project, the original objective was extended - instead of just delivering missing functionalities, it was decided that Comarch Corporate Banking should completly replace existing front-end solutions for business clientsMany banks operating in Thailand use very fragmented internet banking platforms. This means that a customer who wants to access cash management services, and then move to loans or trade finance, often needs to log in to two separate applications.

Corporate Banking encompasses multiple products and services under a single platform, in which the client has easy and uniform access to all business functionalities, regardless of the backend system that provides the data. This makes it much easier to perform day-to-day activities that often require the use of multiple products and services that the bank offers. Thanks to modular architecture of Comarch Corporate Banking, essential products and services were made available to TMB Bank clients in just under 10 months. These included Cash Management, Trade Finance and Lendingmodules.

Ever since the initial deployment, the platform has seen steady growth. The subsequent releases included further enhancements to existing modules as well as introduction of new ones, such as EDC (Merchant reports) and FX (Foreign Exchange). Due to extensible nature of Comarch Corporate Banking, new functionalities can be added at any stage of the project.

Analyse the case.

KARPAGAM ACADEMY OF HIGHER EDUCATION								
Department of Management								
Unit 1- Nature and Scope of Merchant Banking -Multiple Choice Questions- Each Question Carry ONE Mark								
SN	**Question**	**Option-A**	**Option-B**	**Option-C**	**Option-D**	**Answer**		
	Unit - 1							
1	. ______ concentrated on the manual change of different currencies operated locally and later accepted deposits for security reasons. While, ______ who operated internationally, engaged in bill-broking, raising foreign exchange and provision of long term capital for public borrowers.	Money changers, Exchangers	Exchangers, Merchant bankers	Remitters, Exchangers	Merchant bankers, money hangers	Money changers, Exchangers		
2	. ______ is regarded as the fourth element of the financial system.	Financial services	Financial markets	Financial instruments	Financial institutions	Financial services		
3	_____ can be for both equity & debt.	Credit Rating	Financial Service	Financial Sector	Both (a) & (b)	Credit Rating		
4	_____ has made the quality of man-power as one of the criteria for registration as Merchant Bankers.	SEBI	Pre-liberalization	Post-liberalization	Issue Management	Post-liberalization		
5	_____ that are financial in nature are known as financial services.	Services	Goods	Capital	Structure	Goods		
6	______ is not the rational of merchant banking business is to	Creating Investors Confidence	Protection of Small Investors	Ensure Proper Disclosure	Increases NAV	Increases NAV		
7	________ set up on April 30, 1992 to investigate irregularities in funds management by commercial banks & financial institutions.	Jankiraman committee	M.Narasimham Committee	G.S. Patel committee	Chakravarty committee	Jankiraman committee		

8	_________ Shall not include pre issue obligations of a Merchant Banker	Memorandum of Understanding	Other Requirements	Certificate Signed by Professional	Due Diligence Certificate	Other Requirements		
9	A Merchant Bank deals with the Commercial Banking needs of International Finance, Long-term Company Loans, & _____.	Fixed Deposits	Stock Underwriting	Share Investments	Medium-term Loans	Stock Underwriting		
10	A Merchant Bank is a financial institution which provides capital to companies in the form of share ownership instead of _____.	Debentures	Stocks	Loans	DD	Loans		
11	A merchant bank is a financial institution which shall not conducting money market activities and	Lending	Underwriting and financial advice	Investment service	Hedging	Hedging		
12	A Merchant Bank is also known as _____.	World Bank	Commercial Bank	Wholesale Bank	Special Bank	Wholesale Bank		
13	Appointment of Intermediaries of MB shall not include	Appointment of MB	Appointment of Co-Managers	Appointment of other Intermediaries	Brokers	Brokers		
14	Business of Merchant Banking started in India since	1967	1969	1956	1986	1967		
15	Code of Conduct of a Merchant Bankers shall not include	Fair Practice	Best advise	Secrecy	Qualification	Qualification		
16	Code of Conduct of Merchant Bankers is drawn by	SEBI	CLB	ROC	MCA	SEBI		
17	Definition of Merchant Banker does not includes	Selling, Buying	Subscribing to securities	Manager, Consultants	Act as Broker	Act as Broker		
18	Developmental activities of	Commercial	ShareHolders	Expanding	Financial	Expanding		
19	Following shall not be a default of a merchant banker	General Default	Major Default	Serious Default	Minimal Default	Minimal Default		
20	Formal merchant banking activity in India was originated in______.	1978	1969	1980	1987	1969		

21	In India Merchant banking along with management of public issues and loan syndication covering activities like-	Project counseling	Portfolio management	Investment counseling	Mergers and amalgamation of the corporate firms	Project counseling		
22	In India, merchant-banking activity was originated with the merchant banking division set up by the __________.	Barclays Bank	GrindLays Bank	Yes Bank	No Bank	GrindLays Bank		
23	In India, the UTI setup the first _____ in 1964.	Credit Rating	Mutual Fund	Factoring	Leasing	Leasing		
24	Issue management is an important function of ______ and ______.	Public banker, Merchant banker	Lead banker, Private banking	SEBI	Merchant banker, lead manager	Merchant banker, lead manager		
25	Mandatory Collection centres shall include	Mumbai	Hyderabad	Ahmadabad	Haryana	Mumbai		
26	Merchant Bankers act as an intermediaries for	New Issues Markets	Secondary Market	Securities Markets	Money Markets	Securities Markets		
27	Merchant Bankers are classified into ___ category	4	3	2	8	4		
28	Merchant Bankers are not governed under	Merchant Bankers Rules	MOF	Merchant Banking Regulations	CLB	CLB		
29	Merchant Bankers do not supports in project banking which includes	Financial Consideration	Economic	Technological	Commercial	Commercial		
30	Merchant Bankers extend their business towards	Small	Medium	Large	All Business Houses	All Business Houses		
31	Merchant Bankers who are bankers within the meaning of	Ministry of Finance	Government of India	SEBI	Banking Regulation Act	Banking Regulation Act		
32	Merchant Banking does not falls under the purview of	SEBI	MOF	CLB	RBI	RBI		
33	Merchant Banking is to be traced to ______ in late medieval times, and _____, during the 17^{th} and 18^{th} century.	Rome, France	Italy, France	Vietnam, Rome	USA, Europe	Italy, France		

34	Merchant Banking means providing	Financial Services	Non Financial Services	Fund Services	Non Fund Financial Services	Non Fund Financial Services		
35	Merchant Banks also provide advisory services on _____.	Corporate Matters	Financial System	Administration	Investment Decision	Administration		
36	Merchant Banks were inventred in the middle ages by _____.	France	England	Italians	American	France		
37	No Objection Certificate may be also	NC	NOC	No. OC.,	No of Certi.,	NOC		
38	Offer Document shall made public within	20 days	21 days	22 days	23 days	20 days		
39	On the basis of _______, the board will communicate the contents of the report to concerned merchant banker	Monitor Schedule	Optinal Report	Inspection Report	Interium Report	Insperction Repfot		
40	Origin of Merchant Banking	British Banking	Indian Banking	China Banking	Japan Banking	British Banking		
41	Post Issue obligations issue shall not include	Post issue reports	Redressal of Grievance	Underwriters	Bankers to issue	Redressal of Grievance		
42	Regulation 9 of SEBI (Merchant Bankers) Rules and Regulations, 1992 ia all about	Compliance of MB	Filing of MB	Procedures of MB	Registration of MB	Registration of MB		
43	Regulatory Framework of Merchant Banker shall not include	Submission of Offer Document	Despatch of Issue Material	Redressal of Investors Grievance	Discounting	Discounting		
44	The _______ has to manage the post-issue activities	Merchant banker	Lead manager	Bank promoter	Placements	Lead manager		
45	The early growth of merchant banking in the country is assigned to the ________.	Foreign Exchange Regulation Act, 1973	FERA	Securities Contracts Act	Income-tax Act	Foreign Exchange Regulation Act, 1973		
46	The oldest merchant bank in London was	Baring brothers	Lehman brothers	Barclays	Parlays	Baring brothers		
47	The types of financial services in Merchant Banking are _____.	6	4	8	5	4		

48	Whether Merchant Banker can undertake the functions of Banking business	Yes	Yes, provided as per BRA., 1949	With prior permission of CLB	With the permission of RBI	Yes, provided as per BRA., 1949		
49	Which file format to be used to submit it to SEBI	HTML	MS Office	PDF	Zip File	HTML		
50	Which is not a risk ?	Gap Risk	Currency Risk	Market Risk	Investment Risk	Investment Risk		
51	Which is not an criteria for authorisation	Professional Qualification	Past year’s track record	General Reputation	Other Yardstick	Other Yardstick		
52	Which of the following are not the authorised activities of an Merchant Banker	Issue Management	Determination of Financial Structure	Unauthorised Activities	Corporate Advise	Unauthorised Activities		
53	Which of the given service is not a service of a Merchant Banker	Underwriting	Loan Syndication	Registrar of Transfer Agent	Promoter	Promoter		
54	Which of the following are not the code of conduct of a Merchant Bankser	Fair Practice	Best advise	Allotment	Project Appraisl	Project Appraisl		
55	Post Issue obligations issue shall not include	3 day Report	78 day Report	50 day Report	100 day Report	100 day Report		
56	Role of merchant bankers --------.	Mobilizing Cash	Not Promotion Functions	Patent Registration	Innovation Support	Innovation Support		
57	Categproes pf Securities of Corporatae Enterprises includes	Sweat Issue	Bouns Issue	Secondary Issue	Private Placements	Private Placements		
58	One of the factor is not a role of any issue manager	Easy Floatation	Underwriting	Due Diligence	Broking	Broking		
59	Find the odd one of public issues of	IPO	FPO	RI	SEBI	SEBI		
60	Net Asset Value is to measure the	Operational	Functioning	HR	Overll	Operatinal		

UNIT-II- MUTUAL FUNDS

SYLLABUS

Unit II
Mutual Funds – Operation – Performance – SEBI guidance for Mutual Funds Securitization – concept, Securitization as a Funding Mechanism, Securitization of Residential Real Estate – Mortgages & Mortgage Investments.
..

INTRODUCTION TO MUTUAL FUNDS

Mutual funds are institutions that mobilize the savings of innumerable investors for the purpose of channelling them into productive investments in a wide variety of corporate and other securities.

Some of the services rendered by mutual funds are as follows:

1. Mopping up public savings.
2. Investing the funds in a diversified portfolio of shares and debentures belonging to well managed and growing companies.
3. Earning investors, a steady return on investments with an assurance of capital appreciation.

Relief to Sick Industries

Merchant bankers extend the following services as part of providing relief to sick industries:

1. Rejuvenating old-lines and ailing units by appraising their technology and process, assessing their requirements and restructuring their capital base.
2. Evolving rehabilitation packages which are acceptable to financial institutions and banks.
3. Exploring the possibilities of mergers/amalgamations, wherever called for.

Project Appraisal

The evaluation of industrial projects in terms of alternative variants in technology, raw materials, production capacity and location of plant is known as 'Project Appraisal'.

Financial appraisal

Financial appraisal involves assessing the feasibility of a new proposal for setting up a new project or the expansion of existing production facilities.

Financial appraisal is undertaken through an analysis which takes into account the financial features of a project, including sources of financing. Financial analysis helps trace the smooth operation of the project over its entire life cycle.

Technical Appraisal

Technical appraisal is primarily concerned with the project concept in terms of technology, design, scope and content of the plant, as well as inputs are infrastructure facilities envisaged for the project, Basically, the project should be able to deliver a marketable product from the resources deployed, a t a cost which would leave a margin that would be adequate to service the investment, and also plough back a reasonable amount into the project to enable the enterprise to consolidate its positions.

Economic Appraisal

Economic appraisal of a project deals with the impact of the project on economic aggregates. These may be classified under two broad categories. The first deals with the effect of the project on employment and foreign exchange, and the second deals with the impact of the project on net social benefits or welfare.

14 Important Steps Taken by SEBI for Regulating Mutual Funds in India

Important steps taken by SEBI for the regulation of mutual funds are listed below:

(1) Formation:

Certain structural changes have also been made in the mutual fund industry, as part of which mutual funds are required to set up asset management companies with fifty percent independent directors, separate board of trustee companies, consisting of a minimum fifty percent of independent trustees and to appoint independent custodians.

This is to ensure an arm's length relationship between trustees, fund managers and custodians, and is in contrast with the situation prevailing earlier in which all three functions were often performed by one body which was usually the sponsor of the fund or a subsidiary of the sponsor.

Thus, the process of forming and floating mutual funds has been made a tripartite exercise by authorities. The trustees, the asset management companies (AMCs) and the mutual fund shareholders form the three legs. SEBI guidelines provide for the trustees to maintain an arm's length relationship with the AMCs and do all those things that would secure the right of investors.

With funds being managed by AMCs and custody of assets remaining with trustees, an element of counter-balancing of risks exists as both can keep tabs on each other.

(2) Registration:

In January 1993, SEBI prescribed registration of mutual funds taking into account track record of a sponsor, integrity in business transactions and financial soundness while granting permission. This will curb excessive growth of the mutual funds and protect investor's interest by registering only the sound promoters with a proven track record and financial strength. In February 1993, SEBI cleared six private sector mutual funds viz. 20th Century Finance Corporation, Industrial Credit & Investment Corporation of India, Tata Sons, Credit Capital Finance Corporation, Financial Services and Apple Industries.

3) Documents:

The offer documents of schemes launched by mutual funds and the scheme particulars are required to be vetted by SEBI. A standard format for mutual fund prospectuses is being formulated.

(4) Code of advertisement:

Mutual funds have been required to adhere to a code of advertisement.

(5) Assurance on returns:

SEBI has introduced a change in the Securities Control and Regulations Act governing the mutual funds. Now the mutual funds were prevented from giving any assurance on the land of returns they would be providing. However, under pressure from the mutual funds, SEBI revised the guidelines allowing assurances on return subject to certain conditions.

(6) Minimum corpus:

The current SEBI guidelines on mutual funds prescribe a minimum start-up corpus of Rs.50 crore for an open-ended scheme, and Rs.20 crore corpus for closed-ended scheme, failing which application money has to be refunded.

The idea behind forwarding such a proposal to SEBI is that in the past, the minimum corpus requirements have forced AMCs to solicit funds from corporate bodies, thus reducing mutual funds into quasi-portfolio management outfits. In fact, the Association of Mutual Funds in India (AMFI) has repeatedly appealed to the regulatory authorities for scrapping the minimum corpus requirements.

(7) Institutionalisation:

The efforts of SEBI have, in the last few years, been to institutionalise the market by introducing proportionate allotment and increasing the minimum deposit amount to Rs.5000 etc. These efforts are to channel the investment of individual investors into the mutual funds.

(8) Investment of funds mobilised:

In November 1992, SEBI increased the time limit from six months to nine months within which the mutual funds have to invest resources raised from the latest tax saving schemes. The guideline was issued to protect the mutual funds from the disadvantage of investing funds in the bullish market at very high prices and suffering from poor NAV thereafter.

(9) Investment in money market:

SEBI guidelines say that mutual funds can invest a maximum of 25 per cent of resources mobilised into money-market instruments in the first six months after closing the funds and a maximum of 15 per cent of the corpus after six months to meet short term liquidity requirements.

Private sector mutual funds, for the first time, were allowed to invest in the call money market after this year’s budget. However, as SEBI regulations limit their exposure to money markets, mutual funds are not major players in the call money market. Thus, mutual funds do not have a significant impact on the call money market.

(10) Valuation of investment:

The transparent and well understood declaration or Net Asset Values (NAVs) of mutual fund schemes is an important issue in providing investors with information as to the performance of the fund. SEBI has warned some mutual funds earlier of unhealthy market

(11) Inspection:

SEBI inspect mutual funds every year. A full SEBI inspection of all the 27 mutual funds was proposed to be done by the March 1996 to streamline their operations and protect the investor's interests. Mutual funds are monitored and inspected by SEBI to ensure compliance with the regulations.

(12) Underwriting:

In July 1994, SEBI permitted mutual funds to take up underwriting of primary issues as a part of their investment activity. This step may assist the mutual funds in diversifying their business.

(13) Conduct:

In September 1994, it was clarified by SEBI that mutual funds shall not offer buy back schemes or assured returns to corporate investors. The Regulations governing Mutual Funds and Portfolio Managers ensure transparency in their functioning.

(14) Voting rights:

In September 1993, mutual funds were allowed to exercise their voting rights. Department of Company Affairs has reportedly granted mutual funds the right to vote as full-fledged shareholders in companies where they have equity investments.

Securitization

is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. Securities backed by mortgage receivables are called mortgage-backed securities (MBS), while those backed by other types of receivables are asset-backed securities (ABS).

Critics have suggested that the complexity inherent in securitization can limit investors' ability to monitor risk, and that competitive securitization markets with multiple securitises may be particularly prone to sharp declines in underwriting standards. Private, competitive mortgage securitization played an important role in the U.S. subprime mortgage crisis.

In addition, off-balance sheet treatment for securitizations coupled with guarantees from the issuer can hide the extent of leverage of the securitizing firm, thereby facilitating risky capital structures and leading to an under-pricing of credit risk. Off-balance sheet securitizations also played a large role in the high leverage level of U.S. financial institutions before the financial crisis, and the need for bailouts.

The granularity of pools of securitized assets can mitigate the credit risk of individual borrowers. Unlike general corporate debt, the credit quality of securitized debt is non-stationary due to changes in volatility that are time- and structure-dependent. If the transaction is properly structured and the pool performs as expected, the credit risk of all tranches of structured debt improves; if improperly structured, the affected tranches may experience dramatic credit deterioration and loss.

Securitization has evolved from its beginnings in the late 18th century to an estimated outstanding of $10.24 trillion in the United States and $2.25 trillion in Europe as of the 2nd quarter of 2008. In 2007, ABS issuance amounted to $3.455 trillion in the US and $652 billion in Europe. WBS (Whole Business Securitization) arrangements first appeared in the United Kingdom in the 1990s, and became common in various Commonwealth legal systems where senior creditors of an insolvent business effectively gain the right to control the company. There are main players in securitization, they include investors, securiters and corporates.

The Different Methods of Marketing Securities

Methods of Marketing Securities

Following are the various methods being adopted by corporate entities for marketing the securities in the New Issue Market:

- Pure Prospectus Method, Offer for Sale Method, Private Placement Method
- Initial public Offers (IPOs) Method, Rights Issue Method, Bonus Issue Method
- Book-building Method, Stock Option Method and Bought-out Deals Method

Pure prospectus Method

Meaning

The method whereby a corporate enterprise mops up capital funds from the general public by means of an issue of a prospectus, is called 'Pure Prospectus Method'. It is the most popular method of making public issue of securities by corporate enterprises.

Features

Exclusive subscription: Under this method, the new issues of a company are offered for exclusive subscription of the general public.

Issue Price: Direct officer is made by the issuing company to the general public to subscribe to the securities as a stated price.

Underwriting: Public issue through the 'pure prospectus method' is usually underwritten. This is to safeguard the interest of the issuer in the event of an unsatisfactory response from the public.

Prospectus: A document that contains information relating to the various aspects of the issuing company, besides other details of the issue is called a 'Prospectus'. The document is circulated to the public. The general details include the company's name and address of its registered office, the names and addresses of the company's promoters, manager, managing director, directors, company secretary, legal adviser, auditors, bankers, brokers, etc

Advantages

The pure prospectus method offers the following advantages to the issuer and the investors alike:

Benefits to investors: The pure prospectus method of marketing the securities serve as an excellent mode of disclosure of all the information pertaining to the issue. Besides, it also facilitates satisfactory compliance with the legal requirements of transparency, etc.

Benefits to issuers: The pure prospectus method is the most popular method among the larger issuers. In addition, it provides for wide diffusion of ownership of securities contributing to reduction in the concentration of economic and social power.

Drawbacks

The raising of capital through the pure prospectus method is fraught with a number of drawbacks as specified below:

High issue costs: A major drawback of this method is that it is an expensive mode of raising funds from the capital market. Costs of various hues are incurred in mobilizing capital.

Time Consuming: The issue of securities through prospectus takes more time, as its requires the due compliance with various formalities before an issue could take place.

Offer for Sale Method

Meaning

Where the marketing of securities takes place through intermediaries, such as issue houses, stockholders and others, it is a case of 'Offer for sale Method'.

Features

Under this method, the sale of securities takes place in two stages. Accordingly, in the first stage, the issuer company makes an end-block sale of securities to intermediaries such as the issue houses and share brokers of an agreed price. Under the second stage, the securities are re-sold to ultimate investors at a market-related price.

The issue is also underwritten to ensure total subscription of the issue. The biggest advantage of this method is that it saves the issuing company the hassles involved in selling the shares to the public directly through prospectus

Private Placement Method

Meaning

A method of marketing of securities whereby the issuer makes the offer of sale of individuals and institutions privately without the issue of a prospectus is known as 'Private Placement Method.'

Features

Under this method, securities are offered directly to large buyers with the help of share brokers. This method works in a manner similar to the 'Offer for Sale Method' whereby securities are first sold to intermediaries such as issues houses, etc.

Advantages

Private placement of securities offers the following advantages

2. Less expensive as various types of costs associated with the issue are borne by the issue houses and other intermediaries.

3. Placement of securities suits the requirements of small companies.

4. The method is also resorted to when the stock market is dull and the public response to the issue is doubtful.

Disadvantages

The major weaknesses of the private placement of securities are as follows:

1. Concentration of securities in a few hands.

2. Creating artificial scarcity for the securities thus jacking up the prices temporarily and misleading general public.

3. Depriving the common investors of an opportunity to subscribe to the issue, thus affecting their confidence levels.

Initial Public Offer (IPO) Method

The public issue made by a corporate entity for the first time in its life is called 'Initial public Offer' (IPO), Under this method of marketing, securities are issue to successful applicants on the basis of the orders placed by them, through their brokers.

When a company whose stock is not publicly traded wants to offer that stock to the general public, it takes the form of 'Initial public offer'. The job of selling the stock is entrusted to a popular intermediary, the underwriter. The underwriters charge a fee for their services.

Stocks are issued to the underwriter after the issue of prospectus which provides details of financial and business information as regards the issuer.

The issuer and the underwriting syndicate jointly determine the price of a new issue. IPO stock at the release price is usually not available to most of the public. Good relationship between, the broker and the investor is a pre-requisite for the stock being acquired.

Full disclosure of all material information in connection with the offering of new securities must be made as part of the new offerings. A statement and preliminary prospectus (also known as a red herring) containing the following information is to be filled with the Registrar of Companies:

1. A description of the issuer's business.

2. The names and addresses of the Key company officers, with salary and a 5-year business history on each.

3. The amount of ownership of the key officers

4. Any legal proceedings that the company is involved in

The essential steps involved in this method of marketing of securities are as follows:

1. **Order:** Broker receives order from the client and places orders on behalf of the client with the issuer.

2. **Share Allocation**: The issuer finalizes share allocation and informs the broker regarding the same.

3. **The Client:** The broker advises the successful clients of the share allocation. Clients then submit the application forms for shares and make payment to the issuer through the broker.

4. **Primary issue account**: The issuer opens a separate escrow account (primary issue account) for the primary market issue. The clearing house of the exchange debits the primary issue account of the broker and credits the issuer's account.

5. **Certificates:** Certificates are then delivered to investors. Otherwise depository account may be credited.

Rights issue Method

Where the shares of an existing company are offered to its existing shareholders. It takes the form of rights issue. Under this method, the existing company issues shares to its existing shareholder sin proportion in the number of shares already held by them.

The relevant guidelines issued by the SEBI in this regard are as follow Shall be issued only by listed companies.

1. Announcement regarding rights issue once made, shall not be withdrawn and where withdrawn, no security shall be eligible for listing up to 12 months.

2. Underwriting as to rights issue is optional and appointment of Registrar is compulsory.

3. Appointment of category I Merchant Bankers holding a certificate of registration issued by SEBI shall be compulsory.

4. Rights share shall be issued only in respect of fully paid share.

5. Letter of Offer shall contain disclosures as per SEBI requirements.

6. Issue shall be kept open for a minimum period of 30 days and for a maximum period of 60 days.

7. A 'No complaints Certificate' is to be filed by the Legal Merchant Banker' with the SEBI after 21 days from the date of issue of the document.

8. Obligatory for a company where increase in subscribed capital is necessary after two years of its formation of after one year of its first issue of shares, whichever is earlier (this requirement may be dispensed with by a special resolution).

Advantages

Rights issue offers the following advantages

1. **Economy:** Rights issue constitutes the most economical method of raising fresh capital, as it involves no underwriting and brokerage costs.
2. **Easy:** The issue management procedures connected with the rights issue are easier as only a limited number of applications are to be handled.

3. **Advantage to shareholders**: Issue of rights shares does not involve any dilution of ownership of existing shareholders.

Drawbacks

The method suffers from the following limitations:

1. **Restrictive:** The facility of rights issue is available only to existing companies and not to new companies.

2. **Against society**: the issue of rights shares runs counter to the overall societal consideration of diffusion of share ownership for promoting dispersal of wealth and economic power.

3. **Bonus Issues Method**

Where the accumulated reserves and surplus of profits of a company are converted into paid up capital, it takes the form of issue of bonus shares. It merely implied capitalization of existing reserves and surplus of a company.

Issue under Section 205 (3) of the companies Act, such shares is governed by the guidelines issued by the SEBI (applicable of listed companies only) as follows:

SEBI Guidelines

Following are the guidelines pertaining to the issue of bonus shares by a listed corporate enterprise:

1. **Reservation:** In respect of FCDs and PCDs, bonus shares must be reserved in proportion to such convertible part of FCDs and PCDs. The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issues were made.

2. **Reserves:** the bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only.

3. **Dividend mode**: the declaration of bonus issue, in lieu of dividend, is not made.

4. **Fully paid:** The bonus issue is not made unless the partly paid shares, if any are made fully paid-up.

5. **No default**: The Company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof and has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

6. **Implementation:** A company that announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of 6 months from the date of such approval and shall not have the option of changing the decision.
7. **The articles**: The articles of Association of the company shall contain a provision for capitalization of reserves, etc. if there is no such provision in the articles, the company shall pass a resolution at is general body meeting making provision in the Articles of Association for capitalization.

8. **Resolution:** consequent to the issue of bonus shares if the subscribed and paid-up capital exceeds the authorized share capital, the company at its general body meeting for increasing the authorized capital shall pass a resolution.

9. **Book-building Method**

A method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the ‘bids’ received from the prospective shareholders by the lead merchant bankers is known as ‘book-building method’.

The option of book-building is available to all body corporate, which are otherwise eligible to make an issue of capital of the public. The initial minimum size of issue through book-building route was fixed at Rs.100 crores.

The book-building process involves the following steps:

1. **Appointment of book-runners**: the first step in the book-building is the appointment by the issuer company, of the book-runner, chosen from one of the lead merchant bankers. The book-runner in the forms a syndicate for the book building. A syndicate member should be a member of National Stock Exchange (NSE) or Over-the-Counter Exchange of India (OTCEI). Offers of ‘bids’ are to be made by investors to the syndicate members, who register the demands of investors.

2. **Drafting prospectus**: The draft prospectus containing all the information except the information regarding the price at which the securities are offered is to be filed with SEBI as per the prevailing SEBI guidelines. The offer of securities through this process must separately be disclosed in the prospectus, under the caption ‘placement portion category’.

3. **Circulating draft prospectus**: A copy of the draft prospectus filed with SEBI is to be circulated by the book-runner to the prospective institutional buyers who are eligible for firm allotment and also to the intermediaries who are eligible to act as underwriters.

4. **Maintain offer records**: The book-runner maintain a record to the offers received. Details such as the name and the number of securities ordered together with the price at which each institutional buyer or underwriter is willing to subscribed to securities under the placement portion must find place in the record. SEBI has the right to inspect such records.

5. **Intimation about aggregate orders**: The underwriters and the institutional investors shall give intimation on the aggregate of the offers received to the book-runner.

6. **Bid analysis**: The bid analysis is carried out by the book-runner immediately after the closure of the bid offer date. An appropriate final price is arrived at after a careful evaluation of demands at various prices and the quantity.
7. **Mandatory underwriting**: Where it has been decided to make offers of shares to public under the category of ‘Net offer of the Public’, it is incumbent that the entire portion offered to the public is fully underwritten.

8. **Filling with ROC:** A copy of the prospectus as certified by the SEBI shall be filed with the Registrar of Companies within two days of the receipt of the acknowledgement card from the SEBI.

9. **Bank accounts**: The issuer company has to open two separate accounts for collection of application money, one for the private placement portion and the other for the public subscription.

10. **Collection of completed applications**: The book-runner collects from the institutional buyers and the underwriters the application forms along with the application money to the extent of the securities proposed to be allotted to them or subscribed by them.

11. **Allotment of securities**: Allotment for the private placement portion may be made on the second day from the closure of the issue. The issuer company, however, has the option to choose one date for both the placement portion and the public portion.

12. **Payment schedule and listing**: The book-runner may require the underwriters to the 'net offer to the public' to pay in advance all moneys required to be paid in respect of their underwriting commitment by the eleventh day of the closure of the issue.

13. **Under-subscription**: In the case of under-subscription in the 'net offer to the public' category, any spill over to the extent of under subscription is to be permitted from the 'placement portion' category subject to the condition that preference is given to the individual investors.

Advantages of book-building

Book building process is of immense use in the following ways:

1. Reduction in the duration between allotment and listing

2. Reliable allotment procedure

3. Quick listing in stock exchanges possible

4. No price manipulation as the price is determined on the basis of the bids received.

Stock Option or employees Stock Option Scheme (ESOP)

A method of marketing the securities of a company whereby its employees are encouraged to take up shares and subscribe to it is known as 'stock option'. It is a voluntary scheme on the part of the company to encourage employees' participation in the company. The scheme also offers an incentive to the employees to stay in the company.

THE STEPS INVOLVED IN M&A

Following are the steps involved in M&A:

1. **Review of objectives:** The first and foremost step in M&A is that the merging companies must undertake the review of the purpose for which the proposal to merge is to be considered. Major objectives of merger include attaining faster growth, improving profitability, improving managerial effectiveness, gaining market power and leadership, achieving cost reduction, etc. the review of objectives is done to assess the strengths and weaknesses, and corporate goals of the merging enterprise.
2. **Data for analysis:** After reviewing the relevant objective of acquisition the acquiring firm needs to collect detailed information pertaining to financial and other aspects of the firm and the industry. Industry centric information will be needed to make an assessment of market growth, nature of competition, ease of entry, capital and labour intensity, degree of regulation, etc. similarly, firm-centric information will be needed to assess quality of management, market share, size, capital structure, profitability, production and marketing capabilities etc. the date to be collected serves as the criteria for evaluation.

3. **Analysis of Information:** After collecting both industry-specific and firm-specific information, the acquiring firm undertakes analysis of data and the pros and cons are weighed. Data is to be analyzed with a view of determine the earnings and cash flows, area of risk, the maximum price payable to the target company and the best way to finance the merger.

4. **Fixing price:** Price to be paid for the company being acquired shall be fixed taking into consideration the current market value of share of the company being acquired. The price shall usually be above the current market price of the share. A merger may take place at a premium. In such a case, the firm would pay an offer price which is higher that the target firm's pre-merger market value.

5. **Finding merger value:** Value created by merger is to be found so that it is possible for the merging firms to determine their respective share. Merger value is equal to the excess of

combined present value of the merged firms over and above the sum of their individual present values as separate entities. Any cost incurred towards the merging process is subtracted to arrive at the figure of net economic advantage of the merging this advantage is shared between the shareholders of the merging firms.

POSSIBLE QUESTIONS
PART-A
Multiple Choice Questions
Online Examination

PART-B

1. What is a mutual fund?
2. Explain IPO method
3. What are the types of appraisal?
4. Define Stock Option or employees Stock Option Scheme (ESOP).
5. What is a book-building method?

PART-C

1. Discuss Money Market Mutual Funds?
2. Differentiate Index Mutual Funds with Bond Funds.
3. Discuss in detail "Asset Management Company (AMC)"?
4. Explain in detail "Net Asset Value (NAV)"?
5. Discuss about the growth oriented Mutual Funds
6. Differentiate between Balanced Funds and Specialized Funds.
7. Explain the various importance of Mutual Funds.
8. Discuss the various risks in Mutual Funds?
9. Discuss the growth of Merchant Banking business in India.
10. Evaluate the various services of Merchant Banks operating in India.

PART –D

The Trading Procedure on Stock Exchange has been replaced by on-line screen based electronic trading system. This is mainly done to eliminate problems like theft, fake/forged transfers, transfer delays and paper work associated with share certificates or debentures in physical form. This is a process where securities held by the investor in the physical form are cancelled and the investor is given an electronic entry or number so that he/she can hold it as an electronic balance in an account. This has increased the equity cult among the people.

1. Identify and state the process mentioned above.
2. What is the most important requirement for the process identified?
3. State any two values which you think have enhanced the equity cult in the society

KARPAGAM ACADEMY OF HIGHER EDUCATION						
Department of Management						
Unit II- Mutual Funds-Multiple Choice Questions- Each Question Carry ONE Mark						
S.No	**Questions**	**Opt 1**	**Opt 2**	**Opt 3**	**Opt 4**	**Answer**
1	Mutual Funds Origniated from	Belgium	Austria	Egypt	Indonesia	Belgium
2	_____ is not the character of MFs	Trust	Common Goal	Investement	Lending	Lending
3	MF shall not include	Interval Scheme	Seed Money	Index Funds	Sectoral Fund Scheme	Seed Money
4	The one which support tax savings include	Balanced Fund Schem	Gilt Fund Scheme	Income Fund Scheme	Tax Fund Scheme	Tax Fund Scheme
5	Laod Fund, No Load Fund, MMMF goes to	Mutual Fund	Merchant Banker	Venture Capital	Depositories	Mutual Fund

6	MFs in India are not managed by	Bankers	Trustees	Custodians	Sponsor	Bankers
7	List the non funcition of AMC	;istrars & Transfer Ag	Investement Advisors	Legal Advisor	Buyouts	Buyouts
8	Process of Portfolio Management process shall not include	Setting Investment	Portfolio Designing	Liquidity	Portfolio Revision	Liquidity
9	Operatonal Efficiency of Mutual Fund shall include	Net Returns	Gross Returns	Tax Returns	Total Returns	Net Returns
10	NAV shll not include	TMV	CL	SU	Load	Load
11	Causes of poor peroformance of mutual funds shall not be	Expensive Securities	Reduced Returns	Poor use of Investment Alternatives	Lack of Knowledge	Lack of Knowledge

12	Regulatory structure of Mutual Funds shall not be	RBI	SEBI	UTI Guidelines	GOI	GOI
13	Regulation on the constitution & management of MF for a trust shall not	Constitution	Listing	Agreement	Requirement	Listing
14	SEBI(MF) Regularions 1996 contains ______ Schedule	11	12	12	10	11
15	Association of Mutual Fund Industry	AMFI	AMF	IAMF	MFIA	AMFI
16	A closed-end fund is a mutual fund in which shares issue just when the fund is	Organized	Unornised	Copied	Rndom Behavioiur	Organized
17	Closed end mutual funds are trading at discount to NAV.	TRUE	FALSE	Difficult to Say	Irrelevant	TRUE

18	Mutual fund units can be traded easilty _________ brokrage or transaction cost	witout	with	on percentage	as per regulation	witout
19	Mutual fund redemption bring bearish influence on the stock market.	Based on the market	Based on the minds of Investors	TRUE	Demand	TRUE
20	Growth fund is a mutual fund that invests primarily in equity shares	At Times True	TRUE	No at all	Baed on Market	TRUE
21	Balanced fund is a mutual fund that	Gives Fixed Returns	Assure Income	Invests in Debt and Equity	Assure Growth	Assure Growth
22	Trust which pools savings investors who share common financial goal is	Merchant Banker	Mutual Fund	Factoring	Forfaiting	Mutual Fund
23	Types of Mutual Funds includes	Open & Close	Income & Growth	Bond & Sectoral	All six	All Six

24	Operational Classfification shall include	Open & Close End	Income Fund	Gowth Fund	Equity Fund	Open & Close End
25	Equity, Bond, Sectoral, Blaned, Leverage, Gilt, Index and Tax Saving Schemes are	Investement Based	Return Based	Operational Based	All the three	Investement Based
26	Sponsor, Trustee, Custodians, AMC is related with	Forfaiting	Factoring	Merchant Banker	Mutual Funds	Mutual Funds
27	SEBI's requirements for AMC shall not include	Trach Record	Reputation, Expertise	Contribution	Number of Members	Number of Members
28	Portfolio Management process in Mutual Funds may not include	tteing Investement Go	Units to be purchased	Protfolio Designing	Identifying Specific Securities	Units to be purchased
29	Mtutal Funds are govrned by	SEBI	SEBI (MF)	SEBI(MF) Regulatins	SEBI(MF) Regularions	SEBI(MF) Regularions

30	________ is not the objectives of Mutual Funds	Benefits	Growth & BalancedIncome	Industry Specific Funds	Growth	Benefits
31	Investors of mutual funds expects	Dividends	Capital Gains	NAV	Consider all the three	Consider all the three
32	During 1991, a 10 member committed under the Chairmanship of Dr.S.A.Dave constituted for	dy on Factoring Servi	Study on Merchant Bankers	Study on Mutual Funds	Study on Returns on MF	Study on Mutual Funds
33	Any MF is managed by AMC that is appointed by the Sponsor Company or ______	GOI	Trustee	RBI	SEBI	Trustee
34	Sharpe's index and Treynor's index are connected with	Merchant Banker	Mutual Fund	Equity Shares	Debentures	Mutual Fund
35	In general the following are inclded in the Market Players	Commercial Banks	Underwritters	Stock Brokers	Mutual Funds & all	Mutual Funds & all

36	Mutual Funds is one of the __________________ banking system	Brain child of	Innovative	Not a Subsidairy	Organ of RBI	Innovative
37	The First Mutual Funds in India was started during	1964	1965	1974	1975	1964
38	Banks sponsored mutual funds shall not include	BOB	SBI	CAN Bank	Yes	Yes
39	In India MFs may not be classified into ________________ categories	Total Status	Schemes of Operation	Portfolio Objectives	Based on Location	Total Status
40	The yeardstick of judging the performance of MF includes	EPS	DPS	NAV	EBIT	NAV
41	Players of MFs in Indian market shall not include ________	blic Sector Non Bank	Public Sector BankMF	Private Sector MF	Foreign and Foreign Investors	Foreign and Foreign Investors

42	Importnt MF shall not include	Fanklin Templeton	Birla Sun Life	IL & FS MF	Sun Mutual Funds	Sun Mutual Funds
43	An association with interested membrs in investment on financil instruments for mutual benefits	Merchant Banker	Mutual Fund	G-Sec	T-Bills	Mutual Funds
44	Yardstick which measures the performance of MF is	NAV	EPS	Book Value	Market Value	NAV
45	10(35) of Income Tax Act exempts from __________ on incomes from MFs	Tax	Exempted	Deduction	Perquisits	Tax
46	_____________ agencies are authorised to issed guidelines & to supervise and regulate MFs in India	SEBI	GOI	MCA	CLB	SEBI
47	______________ means the houses or conditons that people live in	Housing	Godown	Office	Premesises	Housing

48	Set of all financial arrangements that are made available by housing finance institutions to meet the reqirements of housing is called ___________	Real Estate Financing	Estate Financing	Financing	Real Estate Business	Real Estate Financing
49	Models of Housing projects shall not include	Town Planning Schem	Housing Board Projects	Private Real Estate Developers	Local Promoters	Local Promoters
50	Urban, Rural, Cooperative, Construction, Staff rental housing are housing programmes under	HUDCO	TAAICO	SIDCO	TIIC	HUDCO
51	Slum Clearance and Improvements, resettlement, On-site improvements, in-site improvements are _______ level organisations	State	Central	State & Central	Special Programmes	State
52	Loan amount is fixed on the basis of ____________ repayment capacity, Rate of Interstst Charged, Term of the loan	Customers	Banker	Government	Vendor	Customer
53	Fixed Rate, Floating Rate and value addition are the terms connected with	Real Estate Financing	Housing Financing	Both forms of financing	Bank Home Financing	Housing Financing

54	National Housing Bank was promoted in the year	1988	1985	1982	1980	1988
55	Securitization as a financing technique is concerned with _________ in securities	Buying	Trading	Selling	Lending	Trading
56	Securitization is a process by which the financial relations are converted into transferble ______	Securities	Assets	Fixex Assets	Curent Assets	Securities
57	Concept of SPV comprises of	SPC	SPE	SPV	A & B	A & B
58	List the person who is not benefited out of Securitization	Originator	Investor	Borrowers	Government	Government
59	Asset securitization is a process of separating certain assets from the ________	Liability Side	Asset Side	Balance Sheet	None	Balance Sheet

60	Marketability, Merchantable quality, Wide Distribution, Homogenty are the _____________ of securitization	Factors	Features	Limitations	Advantages	Features

KARPAGAM ACADEMY OF HIGHER EDUCATION						
Department of Management						
Unit II1- FACTORING-Multiple Choice Questions- Each Question Carry ONE Mark						
S.No	**Questions**	**Opt 1**	**Opt 2**	**Opt 3**	**Opt 4**	**Answer**
1	The Word factor has been derived from the Latin word	Facere	Factore	Focatore	Foctaer	Facere
2	The role of an factor is that of an	Principal	Agent	Boss	Servant	Agent
3	Factor creates a relationship between a financial institution and a ___________	Business	Creditor	Debotor	Parties	Business
4	Factoring for the first time intorudced in	UK	USA	France	India	UK
5	Mainteance of accounts, Collectin of Receivables, Protection against risk, Finance are the services of	Forfaiting	Factor	Mutual Funds	Merchant Bankers	Factor

6	Factoring services are both domestic and ________________	International	Natinal	State	Exports	Exports
7	Features of Factoring may not include	Discounting	Cash Advnaces	Create Cover	Collection Services	Discounting
8	Source of Short term fund, credit protection, Helps to increase sales are the _______ of a a factor	Merits	Demerits	Functions	Features	Features
9	Cost of factoring inludes	Commission	Principal	Advnce	Discount	Commission
10	EDI Factoring is a _______________ factoring services in India	Paper	Paperless	Mutual	No such service	Paperless
11	_______ is a fund based financial services	Factor	Forfait	Mutual Fund	Merchant Bankers	Factor

12	C.S. Kalyanasundaram Report (1988) is a part of __________	Factor	Faofait	Financial Services	Non-Finnace Services	Factor
13	Mechanics of fctoring may not include	Merchant	Customer	Factor	Banker	Banker
14	Factoroing which normally arises from any ordinary trnsactions is	Domestic	Disclosed	Undisclosed	Discount	Domestic
15	Players of factoring shall notinclude	Buyer	Seller	Factor	Broker	Broker
16	UNIDROIT is linked with	Merchant Bankers	Mutual Funds	Factoring	Forfaiting	Factoring
17	Domestic factoring means an arrangment between a factor and his client which includes at lease two	Finance & Maintenance of Accounts	Collection of Debts & Protection against risk	Both	As per agreement	Both

18	Factoring contract is similar to that of a ______ contract	Bailment	Negotiable	HP Contract	Quasi Contract	Bailment
19	A factor works in return for a service charge calculated on the ________	Turnover	Outstandings	Receipts	Current Assets	Turnover
20	If the name of the proposed factor is mentioned on the face of the invoice made out by the seller of goods is	Discount	Domestic	Cross Border	Full Service	Domestic
21	If the name of the proposed factor is not mentioned on the face of the invoice made out by the seller of goods is	Disclosed	Undisclosed	Discount	Cross Border	Undisclosed
22	Cross Border Factoring is also called as	National Factoring	International Factoring	Discount Factoring	Domestic Factoring	International Factoring
23	"to make or to do", "to get things done" and " Facere" all leads to the meaning of	Factoring	Forfaiting	Mutual Funds	Merchant Bankers	Factoring

24	A factor is an agent who collects the dues of his client for a certain___	Commission	Charge	Fee	Brokerage	Fee
25	Factor provides finance to his client upto a certain % of unpaid invoices which represent the sale of goods or services to approved ______________	Customers	Clients	Creditors	Debtors	Customers
26	Purchase, Collection of Debts, Sales Ledger Managemnt, Credit Risk, Credit Investigation, Rrendering Consultancy are _____ of factoring	Merits	Demerits	Limitations	Functions	Functions
27	Disclosed factoring and Notified factoring is nothing but ____________ factoring	Invoice	Bulk	International	Full Service	Bulk
28	Full Service Factoring is also called as ___________ factoring	With Recourse	Withuot Recourse	With Course	Without Course	Withuot Recourse
29	With recourse factoring is also called as _____________ charges	Refactoing	Factoring	Full Service	With Recourse	Refactoring

30	In India the idea of providing factoring serivices was frist introduced by ______	Vaghul Working Group	Ramarajan Committee	Basel Norms	Finance Commission	Vaghul Working Group
31	International factoring transactions shall not include	Expoerter	Importer	EF and IF	Banker	banker
32	To assist internatinal factoring, FCI developed special commuication system called	EDIFACT	EIDTACF	IND-EDI	EDIFACT-IND	EDIFACT
33	Strong MIS, Efficinet Monitroring Mechanism, Computerise all operatins, Commercial Viability are the factors of ______	Edifactoing	Ind-Factoring	Int-Ind-Factoring	Factoring	Edifactoing
34	Trade debts have to be assigned in favour of the financing company under	Discounting	Forfeiting	Factoring	Mutual unds	Factoring
35	Refactoring charges have to be paid in the case of	Maturing Factoring	With Recourse Factoring	Invoice Factoring	Full Service Factoring	With Recourse Factoring

36	Under factoring, the factor acts in the capacity of	An agent of his client	A Trustee	A holder of value	An administrator	A holder of value
37	The first bank in India to start factoring busines is	Canara Bank	SBI	PNB	Allahabad Bank	SBI
38	Factoring envisages the sale of trade debts to the factor by the _____	Client	Debtor	Seller	Purchaser	Client
39	Factoring agencies also provides ___________ service	Consultancy	Debt Financing	Support Service	Lending	Consultancy
40	A form of financing of receivables arising from International trade is calle as	forfaiting	factoring	financial services	Other Sertices	forfeiting
41	To be a successful _____________, that there exist a secoundary market	factoring	forfaiting	Discount services	Financial Services	forfeiting

42	Exporter, Importer, Forfaiter, Importers' Bank are mechanics of	factoring	MFs	forfaiting	MBs	forfeiting
43	Surrender some thing or give up one's right means	forfaiting	factoring	MBs	MFs	forfeiting
44	Switzerland during the mid 60s developed the concept of	Treasuy Bill	Notes	forfeit	G-Sec	Forfeit
45	Forfeiting is another source of financing against receivables like	Leasing	Instalment	Mututal Fund	Factoring	Factoring
46	Factoring is short term whereas Forfeiting is __________	Tiny	Short	Medium	Long	Medium
47	Factoring is employed to finance both domestic and export, forfeiting emplyed on	Export Business	Import Business	Both Export & Import	For Factoring	Export Business

48	Central theme of factoring is purchase of invoice, purcahse of export bill is	Forfeiting	Factoring	Both	Mutual Fund	Forfeiting
49	Factoring is in border whereas Forfeiting is on financing aspects of ___ bill	Export	Import	Export Bill	Import Bill	Export Bill
50	Factoring is for whole turnover, whereas forfeiting is on	single export bill	all export bill	single import & expoert bill	All export & import bill	single export bill
51	Profitable, Liquid, Simple, Flexible, Confidential and Speedy transactins are the merits of	Forfeiting	factoring	Mutual Funds	Merchant Banks	Forfeiting
52	Once the factor purchae all the factor, the factor becomes _____________	Holder for value	Agent of the Valaue	Both	Depends	Holder of the value
53	Credit Investigation and analysing Credit Risk are two eyes of	Factoring	Forfeiting	Merchant Bankers	Mutual Funds	Factoring

54	Type of _____ service on the basis of the nature of transaction between client and factor	Factoring	Forfeiting	Maturing Factoring	Agency Factoring	Factoring
55	The factor simply provides finance against invoices without undertaking any other function is	Invoice	Bulk	Maturity	Agency	Invoice
56	Account Receivables under discout are subject to rediscounting which is not possible under	Factoring	Fofeiting	Bill Financing	Notes	Factoring
57	Sales Ledger, Credit Control and Bad Debts administrationi comprises of	Factoring Fee	Brokerage	Commission	Discount Charge	Factoring Fee
58	Factoring Charge = Cost plus _______________	Commission	Loss	Profit	Risk	Profit
59	Sales Ledger Control Accounts contians main __________ account of various debtors of Clients	Asset	Liabilities	Both	Outstanding	Asset

60	Client Current Account contains a statement of account of a client showing all debits and	Credits	Debits	Balance Sheet	Outstandings	Credits

UNIT-III- CONCEPT OF FACTORING

SYLLABUS

Unit III

Concept of Factoring – Forms of Factoring Vs Bill Discounting – Factoring Vs Credit Financing – Factoring Vs Forfeiting – Evaluation of a Factor – Legal aspects of Factoring – Factoring Services in India – Bill of Exchange– Definition – Features..

FACTORING:

FEATURES, TYPES, STEPS, ADVANTAGE AND LIMITATIONS

Factoring is defined as "an outright purchase of credit approved accounts receivables, with the factor assuming bad debt losses."

The modern factoring involves a continuing arrangement under which a financing institution assumes the credit control/protection and collection functions for its client, purchases his receivables as they arise (with or without recourse to him for credit losses, i.e., customer's financial inability to pay), maintains the sales ledger, attends to other book-keeping duties relates to such accounts receivables and performs other auxiliary functions.

Factoring is an asset based method of financing as well as specialized service being the purchase of book debts of a company by the factor, thus realizing the capital tied up in accounts receivables and providing financial accommodation to the company.

The book debts are assigned to the factor who collects them when due for which he charges an amount as discount or rebate deducted from the bills. Thus, the factor is an intermediary between the supplier and customers who performs financing and debt collection services.

In a situation where industry is finding it difficult to obtain funds, the need for better management of book debts by companies had arisen. In this backdrop, 'factoring' services assumed an important role in global business and could help Indian industry overcome debt collection deficiencies in a big way.

The Managing Director of International Factors Ltd., of Singapore Mr. Eugen Tan Eu Jin, noted that "factoring business had a great potential in India and it was in the best interests of the country to develop this financial intermediary. Banks and other financial institutions can as well diversify in this area to increase their profitability."

Factoring can be both domestic and for exports. In domestic factoring, the client sells goods and services to the customer and delivers the invoices, order documents, etc. to the factor and inform the customer of the same.

In return, the factor makes a cash advance and a statement to the client. The factor then sends a copy of all the statements of accounts, remittances, receipts, etc. to the customer, on receiving them, the customer sends the payment to the factor.

In case of export factoring two 'factors' are involved. The factor in the customer's country is called "Import Factor" while the one in the client's country is called the "Export Factor". All the transactions remain similar in the case of international factoring, the only difference being that the export factor has to send the shipping documents to the import factor and the import factor has to pass on the ultimate collection to the export factor.

Credit Syndication

Credit syndication relates to activities connected with credit procurement and project financing, aimed at raising Indian and foreign currency loans from banks and financial institutions, are collectively known as 'credit syndication'.

Activities covered under credit syndication are as follows:

1. Estimating the total cost of the project to be undertaken.
2. Drawing up a financing plan for the total project cost which conforms to the requirements of the promoters and their collaborators, financial institutions and banks, government agencies and underwriters.
3. Preparing loan application for financial assistance from term lenders/financial institutions/banks, and monitoring their progress, including pre-sanction negotiations.
4. Selecting institutions and banks for participation for financing.

Credit syndication services overlap with the act ivies of project counselling and project finance. But the loan syndication also includes the preparation of applications for financial assistance from financial institutions/banks.

Issue Management and Underwriting

Issue management and underwriting concerns with the activities relating to the management of the public issues of corporate securities, viz. equity shares, preference shares, and debentures of bonds, and are aimed at mobilization of money from the capital market.

Following are some of the popular services provided by merchant bankers in this regard:

- Preparation of an action plant.
- Preparation of budget for the local expenses for the issues.
- Preparation of CCI application and assisting in obtaining consent/acknowledgement.
- Drafting of prospectus
- Selection of institutional and broker underwriters for syndicating/underwriting arrangements.
- Selection of issues Houses and advertising agencies for undertaking pre and post-issue publicity.
- Obtaining the approval of institutional underwriters and stock exchanges for publication of the prospectus.

Portfolio management is making decisions for the investment of cash resources of a corporate enterprise in marketable securities by deciding the quantum, timing and the type of security to be bough.

The services covered are as follows:

1. Undertaking investment in securities.
2. Undertaking investment for non-resident Indians, on both repatriation and non-repatriation basis.
3. Undertaking review of Provident fund investment, Trust investment, etc.
4. Safe custody of securities in India and overseas.
5. Providing advice on selection of investments.
6. Carrying out a critical evaluation of investment portfolio.
7. Collecting and remitting interest and dividend on investment.

Working Capital Finance

The finance required for meeting the day-to-day expenses of an enterprise is known as 'Working Capital finance'.

1. Assessment of working capital requirements.
2. Preparing the necessary application to negotiations for the sanction of appropriate credit facilities.
3. Assisting, co-coordinating and expediting documentation and other formalities for disbursement.
4. Advising on the issue of debentures for augmenting long-term requirements of working capital.

Acceptance Credit and Bill discounting

Acceptance credit and bill discounting connotes the activities relating to the acceptance and the discounting of bills of exchange, besides the advancement loans to business concerns on the strength of such instruments, are collectively known as 'Acceptance Credit and Bill of discounting.

In order that the bill accepting and discounting takes place on sound lines, it is imperative that the firm involved command a good reputation and financial standing.

Salient Features of Factoring:

(i) Credit Cover:

The factor takes over the risk burden of the client and thereby the client's credit is covered through advances.

(ii) Case advances:

The factor makes cash advances to the client within 24 hours of receiving the documents.

(iii) Sales ledgering:

As many documents are exchanged, all details pertaining to the transaction are automatically computerized and stored.

(iv) Collection Service:

The factor, buys the receivables from the client, they become the factor's debts and the collection of cheques and other follow-up procedures are done by the factor in its own interest.

(v) Provide Valuable advice:

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

Types of Factoring:

The types of factoring are discussed below:

(i) Recourse Factoring
(ii) Non-Recourse Factoring
(iii) Advance Factoring
(iv) Confidential and Undisclosed Factoring
(v) Maturity Factoring.
(vi) Supplier Guarantee Factoring
(vii) Bank Participation Factoring

The detail about the Types of Factoring is as follows:

(i) In Recourse factoring the credit risk remains with the client though the debt is assigned to the factor, i.e., the factor can have recourse to the client in the event of non-payment by the customer.

(ii) The Non-Recourse Factoring also called as 'Old-line factoring'. It is an arrangement whereby he factor has no recourse to the client when the bill remains unpaid by the customer. Thus, the risk of bad debt is absorbed by the factor.

(iii) Where the payment is made by the factor immediately is called Advance Factoring Under this type of factoring, the factor provides financial accommodation apart from non-financial services rendered by him.

(IV) In confidential and undisclosed factoring the arrangement between the factor and the client are left un-notified to the customers and the client collects the bills from the customers without intimating them to the factoring arrangements.

(v) In maturity factoring method, the factor may agree to pay an amount to the client for the bills purchased by him either immediately or on maturity. The later refers to a date agreed upon on which the factor pays the client.

(vi) Supplier Guarantee Factoring is also known as 'drop shipment factoring'. This happens when the client is a mediator between supplier and customer. When the client is a distributor, the factor guarantees the supplier against the invoices raised by the supplier upon the client and the goods may be delivered to the customer. The client thereafter raises bills on the customer and assigns them to the factor. The factor thus enables the client to make a gross profit with no financial involvement at all.

(vii) In bank participation factoring the bank takes a floating charge on the client's equity i.e., the amount payable by the factor to the client in .respect of his receivables. On this basis, the bank lends to the client and enables him to have double financing.

Steps Involved in Factoring:

The steps involved in factoring are discussed below:

Step I. The customer places an order with the seller (the client).

Step II. The factor and the seller enter into a factoring agreement about the various terms of factoring.

Step III. Sale contract is entered into with the buyer and the goods are delivered. The invoice with the notice to pay the factor is sent along with.

Step IV. The copy of invoice covering the above sale is sent to the factors, who maintain the sales ledger.

Step V. The factor prepays 80% of the invoice value.

Step VI. Monthly Statements are sent by the factor to the buyer.

Step VII. If there are any unpaid invoices follow up action is initiated.

Step VIII. The buyer settles the invoices on expiry of credit period allowed

Step IX. The balance 20% less the cost of factoring is paid by the factor to the client.

Advantage of Factoring:

1. It is help to improve the current ratio. Improvement in the current ratio is an indication of improved liquidity. Enables better working capital management. This will enable the unit to offer better credit terms to its customers and increase orders
2. It is increase in the turnover of stocks. The turnover of stock into cash is speeded up and this results in larger turnover on the same investment.
3. It ensures prompt payment and reduction in debt.
4. It helps to reduce the risk. Present risk in bills financing like finance against accommodation bills can be reduced to minimum.
5. It is help to avoid collection department. The client need not undertake any responsibility of collecting the dues from the buyers of the goods.

Limitations of Factoring:

1. Factoring is a high risk area, and it may result in over dependence on factoring, mismanagement, over trading of even dishonesty on behalf of the clients.
2. It is uneconomical for small companies with less turnover.

3. The factoring is not suitable to the company's manufacturing and selling highly specialized items because the factor may not have sufficient expertise to assess the credit risk.

4. The developing countries such as India are not able to be well verse in factoring. The reason is lack of professionalism, non-acceptance of change and developed expertise.

Legal aspects of factoring

Factoring contract is like any other sale- purchase agreement regulated under the law of contract. There is no codified legal framework / code to regulate factoring services in India. The legal relationship between a factor and a client is largely determined by the terms of the factoring contract entered into before the factoring process starts. Some of the contents of a factoring agreement and legal obligations of the parties are listed as follows:

1) The client gives an undertaking to sell and the factor agrees to purchase receivables subject to terms and Conditions mentioned in the agreement.

(2) The client warrants that the receivables are valid enforceable, undisputed and recoverable. He also undertakes to settle disputes, damages and deduction relating to the bills assigned to the factor.

(3) The client agrees that the bills purchased by the factor on a non-recourse basis (i.e. approved bills) will arise only from transactions specifically approved by the factor or those falling within the credit limits authorized by the factor.

(4) The client agrees to serve notices of assignments in the prescribed form to all those customers whose receivableshavebeenfactored.

(5) The client agrees to provide copies of all invoices, credit notes, etc., relating to the factored accounts, to the factor and the factor in turn would remit the amount received against the factored invoices to the client.

(6) The factor acquires the power of attorney to assign the debts further and to draw negotiable instruments in respect of such debts.

(7) The time frame for the agreement and the mode of termination are specified in the agreement.

(8) The legal status of a factor is that of an assignee. The customer has the same defence against the factor as he would have against the factor as he would have against the client.

(9) The customer whose account has been factored and has been notified of the assignment is under legal obligation to remit the amount directly to the factor failing which he will not be discharged from his obligation to pay the factor even if he pays directly to the client remits the amount to the factor.

(10) Before factoring a receivable, the factor requires a letter of disclaimer from the bank which has been financing the book debts through bank finance to the effect that from the date of the letter the bank cannot create a charge against the receivables i.e. the bank will not provide post-sales finance as the factor provides.

(11) Priority over other claimants to book debts: It will be extremely important for the factor to make sure that the book debts it handles are free from any encumbrances which would entitle someone else to the money due. The firm has to guarantee that the book debts are free from any rights of a third party in the factoring agreement.

(12) Other powers: The factor has sometimes to act quickly to recover money due on an invoice. A customer with money outstanding to the factor may be in difficulty and nay delays in acting could see the money gone forever. The agreement must provide for the factor to act swiftly in his name, whenever necessary.

(13) The factoring agreement sets out in detail how the firm s to be paid.

Approved and unapproved debts: The attraction of factoring for many companies is that non-recourse factoring can give a degree of insurance against the customer who does not pay. This depends on whether the debt is approved or not, which is decided before the factoring process starts.

(15)Where the factor may reclaim money already advanced. Factoring agreements provide for payment by the customer directly to the factor. If any of the customers pay it to the client by mistake, the agreement provides that the firm must hold the money for the factor. If he does not do so, this is effectively a breach

of trust and the firm may be held responsible for any losses incurred by the factor.

(16) Warrants Some warrants that are required are:

(a) The firm should disclose any materials facts that it knows might affect the factor's decision to approve a debt.

(b) It has to warrant that the invoices sent for factoring represents a proper debt for goods supplied. (17) Disputed debts: The factor may require the customer to notify it immediately in case of disputed debts. The firm may be expected to return any advances made to it in respect of the disputed debt. (18) The factor's power to inspect the firm's books and accounts and the period of the factoring arrangements is usually laid down in the agreement.

Types of Factoring

Factors take different forms, depending upon the type of specials features attached to them. Following are the important forms of factoring arrangements:

1. **Domestic Factoring:** Factoring that arises from transactions relating to domestic sales is known as Domestic Factoring_. Domestic Factoring may be of three types, as described below.

2. **Disclosed factoring:** In the case of disclosed factoring 'the name of the proposed actor is mentioned on the face of the invoice made out by the seller of goods. In this type of factoring, the payment has to be made by the buyer directly to the Factor named in the invoice. The arrangement for factoring may take the form of recourse_, whereby the supplier may continue to bear the risk of non-payment by the buyer without passing it on to the Factor. In the case of nonrecourse factoring, Factor, assumes the risk of bad debt arising from non-payment.

3. **Undisclosed factoring:** Under undisclosed factoring_, the name of the proposed Factor finds no mention on the invoice made out by the seller of goods. Although the controls of all monies remain with the Factory, the entire realization of the sales transaction is done in the name of the seller. This type of factoring is quite popular in the UK.

4. **Discount factoring:** Discount Factoring 's a process where the Factor discounts the invoices of the seller at a pre-agreed credit limit with the institutions providing finance. Book debts and receivables serve as securities for obtaining financial accommodation.

5. **Export Factoring:** When the claims of an exporter are assigned to a banker or any financial institution, and financial assistance is obtained on the strength of export documents and guaranteed payments, it is called export factoring'. An important feature of this type of factoring is that the Factor bank is located in the country of the exporter. If the importer does not honour claims, exporter has to make payment to the Factor. The Factor-bank admits a usual advance of 50 to 75 percent of the export claims as advance. Export factoring is offered both as a re-course' and as a non-recourse' factoring.

6. **Cross-border Factoring:** Cross-border Factoring' involves the claims of an exporter which are assigned to a banker or any financial institution in the importers' country and financial assistance is obtained on the strength of the export documents and guaranteed payments. International factoring essentially works on a non-recourse factoring model. They handle exporter's overseas sales on credit terms. Complete protection is provided to the clients (exporter against bad debt loss on credit-approved sales. The Factors take requisite assistance and avail the facilities provided for export promotion by the exporting country. When once documentation is complete, and goods have been shipped, the Factor becomes the sole debtor to the exporter.

7. Full-service Factoring: Full-service factoring, also known as Old-line factoring, is a type of factoring whereby the Factor has no recourse to the seller in the event of the failure of the buyers to make prompt payment of their dues to the Factor, which might result from financial inability/ insolvency/bankruptcy of the buyer. It is a comprehensive form of factoring that combines the features of almost all factoring services, especially those of non-recourse and advance factoring.

8. With Recourse Factoring: The salient features of the type of factoring arrangement are as follows

1. The Factor has recourse to the client firm in the event of the book debts purchased becoming irrecoverable

2. The Factor assumes no credit risks associated with the receivables

3. If the consumer defaults in payment, the resulting bad debts loss shall be met by the firm

4. The Factor becomes entitled to recover dues from the amount paid in advance if the customer commits a default on maturity

5. The Factor charges the client for services rendered to the client, such as maintaining sales ledger, collecting customer ‘s debt, etc.

9. **Without Recourse Factoring:** The salient features of this type of factoring are as follows: 1. No right with the Factor to have recourse to the client 2. The Factor bears the loss arising out of irrecoverable receivables 3. The Factor charges higher commission called commission_ as a compensation for the said loss 4. The Factor actively involves in the process of grant of credit and the extension of line of credit to the customers of the client

10. Advance and Maturity Factoring: The essential features of this type of factoring are as follows: 1. The Factor makes an advance payment in the range of 70 to 80 percent of the receivables factored and approved from the client, the balance amount being payable after collecting from customers 2. The Factor collects interest on the advance payment from the client 3. The Factor considers such conditions as the prevailing short-term rate, the financial standing of the client and the volume of turnover while determining the rate of interest

11. **Bank Participation Factoring:** It is variation of advance and maturity factoring. Under this type of factoring, the Factor arranges a part of the advance to the clients through the banker. The net Factor advance will be calculated as follows: (Factor Advance Percent X Bank Advance Percent)

12. **Collection / Maturing Factoring:** Under this type of factoring, the Factor makes no advancement of finance to the client. The Factor makes payment either on the guaranteed payment date or on the date of collection, the guaranteed payment date being fixed after taking into account the previous ledger experience of the client and the date of collection being reckoned after the due date of the invoice.

Factoring trends in India

Introduction

India today offers paramount opportunities for growth, with a stable and positive economic and political environment.

Many global institutions, such as the World Bank, International Monetary Fund, and Asian Development Bank, have put India's growth forecast at between 7.5-8 per cent, calling it the fastest expanding national economy. Industrial growth is slowly picking up. The government has given a huge impetus to infrastructure activities and taken several steps to foster economic development, of which factoring can take advantage.

Factoring Industry Environment

Factoring in India is the selling or discounting of invoices (receivables) by a seller of goods and services, usually micro, small and medium enterprises (MSMEs) to a factoring company or bank. Ideally it should lead to an improvement in collection management, whereby the MSME derives the advantage of realising the receivables quickly against the standard waiting period, which is the essence period of the bill. Large corporates (the buyers) would pay these sellers well after the due dates as per their payment cycle.

These MSMEs play a vital role for the growth of Indian economy, contributing 45 per cent of the industrial output, 40 per cent of exports, 42 million in employment, creating one million jobs every year and producing more than 8000 products for the Indian and international markets. As a result, MSMEs are today exposed to greater opportunities for expansion and diversification across the sectors. The Indian market is growing rapidly and industry is making remarkable progress in various sectors, such as: manufacturing; precision engineering; food processing; pharmaceuticals; textile & garments; retail; IT; agriculture; and service sectors. MSMEs are finding increasing opportunities to enhance their business activities in these core sectors.

One of the key constraints impacting the MSMEs is inadequate finance, particularly working capital. In the case of MSMEs, the need for quick conversion of trade receivables - an important component of current assets of their business entities - into cash, assumes great importance, since the lack of opportunities affects their liquidity, and thereby their business, quite significantly. It has, however, been observed that, at present, not many avenues exist for these enterprises to convert their receivables before maturity except through availing of a bill finance facility from a bank. One of the principal instruments of working capital is trade finance, including bill discounting and factoring. It is estimated that only 10 per cent of the total receivables market is presently covered under the formal bill discounting mechanism in the financial system, while the rest is covered under conventional cash credit/overdraft arrangements with banks. The MSMEs' smaller balance sheets and asset quality act as constraint in their ability to avail of banking limits.

Other issues affecting the market environment include weak credit infrastructure and late payment by large buyers. Factoring companies and banks face difficulties in procuring credit information of the buyers, and have to rely largely on self-assessment of these buyers where possible. Late payment has always been an impediment to supplier growth. Most MSMEs can hardly withstand the burden of late payments but still these firms usually extend credit beyond the agreed tenor to accommodate delayed payment, else they can end up losing the buyer's business. Most of the major corporates, including large public sector enterprises, follow a monthly payment cycle irrespective of the invoice due date. The business orientation of large industries often affects the MSMEs directly, in turn hampering the recycling of funds and business operation of MSME units.

Market Performance and Supply

Letter of credit market share as a trade financing tool is less than 10 per cent of the total country exports, leaving a huge opportunity for open account trade finance. In India, factoring is still to pick up pace, even though it has been around for more than two decades. As per Factors Chain International statistics, 2014 factoring volumes in India stand at around only $5.2 billion, of which $4.2 billion is domestic trade.

Factoring companies in India do offer various types of services depending upon client needs, including recourse and non-recourse factoring, domestic and international factoring, and disclosed and undisclosed factoring. Most deals done in India are with recourse to the corporate, since the factoring company and bank are not able to cover the credit risk on the buyer. This is mainly because credit insurance is not allowed, as per regulations in India, for the purpose of factoring. Thus, there is a need to build a suitable institutional infrastructure which will not only enable an efficient and cost effective factoring and reverse factoring process to be put in place, but also ensure sufficient liquidity is created for all stakeholders through an active secondary market for the same.

In order to address this issue, the Reserve Bank of India (RBI) published a concept paper on 'Micro, Small & Medium Enterprises (MSME) Factoring-Trade Receivables Exchange' in 2014. It involved the setting up of an institutional mechanism for financing trade receivable known as a 'Trade Receivables Discounting System' (TREDS). The transactions processed under TREDS will be non-recourse to the sellers. TREDS will provide the platform to bring sellers, buyers, and financiers together for facilitating uploading, accepting, discounting, trading, and settlement of MSME invoices. Initially TREDS would facilitate the discounting of these factoring units by the financiers resulting in flow of funds to the MSMEs with final payment of the factoring bill being made by the corporate buyer to the financier on due date. Later on, TREDS would enable further discounting /re-discounting of the discounted factoring units by the financiers, thus resulting in assignment in favour of other financiers. The RBI is expected to release further information on the functioning of the exchange once the TREDS exchange operator is identified.

It is felt by many that things can be done to improve the market opinion and share of factoring in the country, such as: creation of greater awareness, especially among MSMEs, on the benefits of both domestic and export factoring; addressing the liquidity constraints facing factors; factors and regulators simplifying products and transactions; a review of why factoring companies are not allowed to avail of credit insurance; clarification on whether the exemption granted in the Factoring Regulation Act, 2011 overrides existing state stamp laws on assignment; and standardising seller balance sheet treatment with regard to non-recourse factoring.

Future Trends

There have been various measures undertaken recently in trying to address the challenges faced by the factoring industry, and increase the scope for factoring across the country. The Enactment of the Factoring Regulation Act, 2011, was done with the aim of regulating assignment of receivables in favour of factors, and delineating the rights and obligations of parties to assignment of receivables. Broad features of the act include: assignment of debts under factoring being exempted from stamp duty; assignment of debts being provided with legal recognition; and notice of assignment being made mandatory.

In addition to the launch of TREDS, the RBI has introduced factors as a new category of non-banking financial company (NBFC). It has also simplified the eligibility criteria with regard to principal business – the NBFC Factor needs to ensure that financial assets in the factoring business constitute at least 50 per cent of its total assets, and that its income derived from factoring business is not less than 50 per cent of its gross income, as against 75 per cent previously. RBI rulings mean factors can now also access credit information from credit bureaus.

In order to facilitate factoring transactions for MSMEs, the government has approved establishment of a Credit Guarantee Fund For Factoring (CGFF), set at Rs. 500 Crore. The credit guarantee for factoring has the advantage of motivating the factors to increase their lending to MSMEs against factored debts by partially sharing their risk, and leading to an increase in actual availability of credit to MSMEs.

These steps, along with the improved economic sentiment, should help drive factoring industry development and change the face of conventional working capital finance in the country.

Monetary Policy Committee

Interest rate policy is set by the Monetary Policy Committee (MPC), which has nine members. It is led by the Governor of the Bank of England; this is a civil service post with the appointment usually going to a career bank employee. The three deputy governors for monetary policy; financial stability; and markets and policy serve on the committee as well as the BoE's chief economist. The final four members are appointed by the Chancellor of the Exchequer, who is equivalent to the Secretary of the Treasury in the United States.

The MPC meets once a month to consider the need to change interest rate policy to achieve the government's inflation target. Each member of the committee has one vote, and a consensus of opinion is not required. The BoE raises and lowers the bank rate, which is the rate charged to domestic banks. When the global financial market crisis hit in October 2008, the bank rate was 5%. It was reduced to 0.5% by March 2009, but the cuts failed to stimulate the economy. The MPC added additional stimulus through the Asset Purchase Facility, a process known as quantitative easing (QE).

With the possibility that Britain could exit the European Union, a scenario known as Brexit for British Exit, the BoE has been charged with developing plans to deal with potential economic fallout. Possible developments include inflationary pressure from a collapse of the British pound or a weakening economy that could require interest rate cuts.

What is Factoring and Forfating ?

Factoring also known as **account receivables factoring** or debtor financing , is a method in which **a company (client)** sell its account receivables (debt) to a **bank or financial institution (called factor)** at a certain discount.

There are three parties involved in factoring contract –

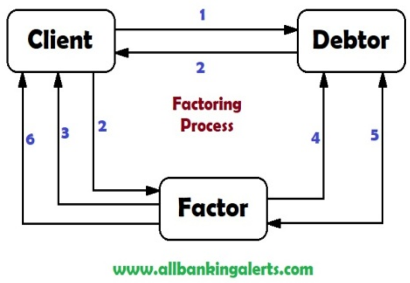
1. **Debtor (Buyer of Goods) –** One who has purchase goods or services on credit and has to pay for same once the credit period gets over.

2. **Client (Seller of Goods) –** who has supplied goods or services to the customer on credit terms.

3. **Factor (Financier) –** who purchase the account receivables from client (seller of goods) and collect the money from debtor of his clients.

In other words, Factoring is a mechanism in which an **exporter (seller)** transfer his rights to receive payment against goods exported or services rendered to the **importer**, in exchange for instant cash payment from a forfaiter. Factoring is prevalent in business in various ways. For example, Credit Card. Factoring is often more short term than forfaiting and is applicable where receivables are due within around 90 days.

Factoring Process



1 – Client concludes a credit sale with the customer

2 – Client sells the account receivable to the factor (financier) and notify the same to customer

3 – Factor makes a part payment (advance) against the account receivable purchased after adjusting the discount or commission and interest on advance.

4 – Factor maintains the customer's account and follows up the payment

5 – Debtor makes the payment due to the factor

6 – Factor makes the final payment to the client when the account receivable is collected or on a guaranteed **payment date.**

Forfeiting

In Forfeiting, Exporter sell their medium and long term account receivables at a discount and obtain cash from the forfeiter on **non recourse basis**. In Forfeiting, there is no risk for exporter of importer becoming insolvent as there is **100 percent finance** of contract value. Forfeiting is generally evidenced by a legally enforceable and transferable payment obligation such as bills of exchange, promissory note, a letter of credit.

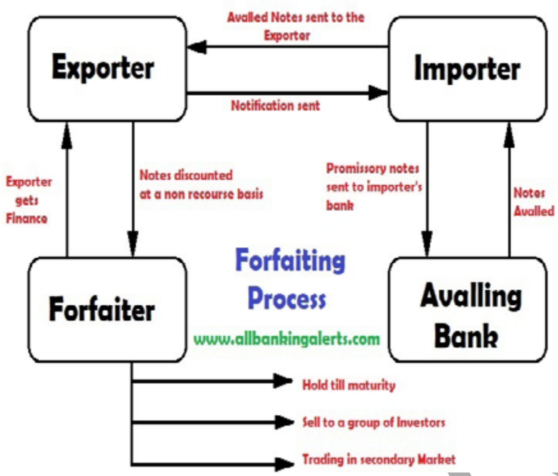
Forfaiting is a specialized form of factoring which is undertaken on export transactions on a non recourse basis. The major parties involved in a transaction of Forfeiting are : An exporter, an importer, a domestic bank, a foreign bank and a primary forfeiter.

Forfeiting Process

Exporter sells the goods to importer on deferred payment basis. Importer issues series of promissory notes undertaking to pay the exporter in installments with interest.

Importer approaches its banker (Availing Bank) for adding the bank guarantee on the promissory note that the payment will be made on each maturity date. Availed notes are sold to forfeiter (usually exporter's bank) as a discount at a non recourse basis and exporter obtain finance from forfeiter.

Forfeiter hold till maturity date and obtain payment from importer's bank / availing bank or sell it in the secondary market or sell it to a group of investors.



Key Differences between Factoring and Forfaiting

Basis for difference	Factoring	Forfaiting
Definition / Meaning	Factoring is the process in which you receive advance against account receivables / debt from the factor (bank or financial institution) without waiting for payment in future.	In Forfaiting, Exporter sell their medium and long term account receivables and obtain cash from the forfaiter.
Maturity of Receivables	It involves account receivables of short term maturities	It involves account receivables of medium and long term maturities.
Extent of Finance	Usually 80-90 percent of the value of invoice.	100 percent of value of invoice.
Type	Recourse Factoring and Non Recourse Factoring	Non Recourse
Credit Worthiness	Factor does the credit rating in case of no recourse factoring transaction.	Forfaiting Bank relies on the creditability of the Avalling Bank.
Cost	Factoring Cost is borne by the Client (seller).	Cost of forfaiting borne by the overseas buyer

Services Provided	Day to Day administration of sales and other allied services are provided	No Services are provided
Negoatiable Instruments	No dealing with Negotiable Instruments	Forfaiting is evidenced by bills of exchange, promissory note, a letter of credit

Difference Between Bill Discounting and Factoring

Bill Discounting

- Bill discounting is a method of trading or selling the bill of exchange to any financial institution like banks before it becomes matured with a less price than its par value.
- Discount on a bill of exchange is based on the remaining time for a maturity of it.
- A bill of discounting involves trade debts which are backed by account receivables.
- In simple language, Bill of discounting is an advance against the bill.

Process

Step - 1
The bank must satisfy itself about the credibility of the drawer before giving money.
Step – 2
A bank will deduct fees or discount from the granted money and then give the reaming money.
Step – 3
Once the bank purchases the bill of discounting it becomes an owner of the bills and if customer delays payment then he has to pay an interest rate to the bank at the directed rates.
Step – 4
If the customer does not pay bills on time and becomes a defaulter in that case bank has right over the goods or services provided by the borrower to the customer.

Factoring

- Factoring is a process in which the customer or borrower sells its debts to the financial institution or a factoring company at a discount.
- Factoring finance deals in account receivables it means invoices.
- A factoring company deducts the interest charges on financial services and commission charges for additional services from the factoring charges.
- A customer gives the instruction to transmit payment directly to the factoring company and settles the due balance.
- A factoring company provides the number of services to the customer like Credit Investigation, Debtors Ledger Maintenance, Collection of Debts, Credit Reports on Debtors and much more.

Process:

The factoring process mainly divided into two parts

Step - 1

The Initial account setup It takes one to two weeks and includes various formalities like submitting an application, file of clients, report of invoices and a sample invoice.

Step – 2

Ongoing funding - This process comprises the detailed underwriting during the period in which the factoring company asks for additional papers like paper of incorporation, bank statements. If it is approved the business will get a maximum credit line from which they can draw.

Difference Between Bill Discounting and Factoring

Basis	Bill discounting	Factoring
Meaning	Bill discounting means to trade bill before it becomes due for payment at par value.	Factoring means to sell its bool debt to the financial transaction to the factoring company at a discount.
Existence	Bill discounting comes under the Negotiable instrument act, 1881.	There is no such specific law for factoring.
Settlement of finance	In bill discounting, the bill is discounted and paid when the transaction takes place.	In factoring, the financer gives a maximum amount as an advance when a transaction takes place the remaining amount at the time of settlement.
Parties involved	In bill discounting there is a drawer, drawee, and a payee.	In factoring, there is a factoring company, debtor and a customer.
Fees	A financer charges fees in the form of discounting charges or interest.	Financer gets fees in the form of interest for the financial services and commission for extra services facilitate.

Bill of Exchange

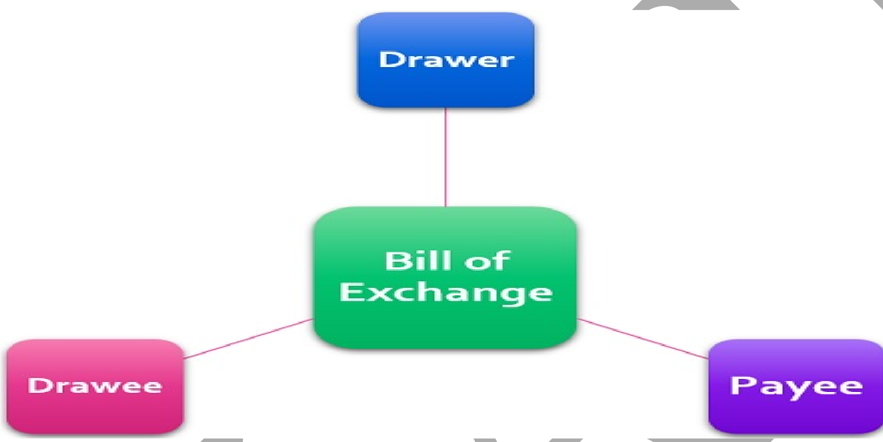
Definition: Bill of Exchange, can be understood as a written negotiable instrument, that carries an unconditional order to pay a specified sum of money to a designated person or the holder of the instrument, as directed in the instrument by the maker. The bill of exchange is either payable on demand, or after a specified term.

In a business transaction, when the goods are sold on credit to the buyer, the seller can make the bill and send it to the buyer for acceptance, which contains the details such as name and address of the seller and buyer, amount of bill, maturity date, signature, and so forth.

Features of Bill of Exchange

- An instrument which a creditor draws upon his debtor.
- It carries an absolute order to pay a specified sum.
- The sum is payable to the person whose name is mentioned in the bill or to any other person, or the order of the drawer, or to the bearer of the instrument.
- It requires to be stamped, duly signed by the maker and accepted by the drawee.
- It contains the date by which the sum should be paid to the creditor

Parties to Bill of Exchange



1. **Drawer**: The person who makes the bill, or who gives the order to pay a certain sum of money, is the drawer of the instrument.
2. **Drawee**: The person who accepts the bill of exchange, or who is directed to pay a certain sum, is called drawee.
3. **Payee**: The person receiving payment is called the payee, who can be a designated person or the drawer himself.

Now, apart from the parties mentioned above, there are some other parties to a bill of exchange, described as under:

- **Drawee, in case of need**: If in any bill of exchange, a person's name is mentioned in addition to the original drawee, who can be resorted for payment. Then, that person will be called as drawee.
- **Holder**: The holder of the bill of exchange, is the person who possesses the bill and who has the right to recover the amount from the parties.

- **Acceptor**: The person who accepts the bill is called acceptor. Usually, a debtor or drawee is the acceptor. However, it can be accepted by some other person also, on behalf of the debtor/drawee.

- **Endorser**: If the holder of the bill, endorses it to another person, then the person will be called as the endorser.

- **Endorsee**: The person to whom the bill of exchange is endorsed, is called as an endorsee.

Specimen of Bill of Exchange

STAMP

Mr. Alpha (Drawer)
576, Gurugram
Feb 17, 2018

₹ 1,00,000

Three months after date, pay to Mr. Beta (payee) a sum of rupees one lakh, for the value received.

To,
Mr. Gamma (drawee)
268, Noida

Mr. Alpha
Sd/-

Joseph gives a loan of Rs.1,00,000 to Alex, which Alex has to return after three months. Further, Joseph has bought certain goods from Peter, on credit for Rs. 1,00,000. Now, Joseph can create a document directing Alex, to pay Rs. 1,00,000 to Peter, after three months.

The instrument will be called as Bill of Exchange, which is transferred to Peter, on whom the payment is due, for the goods purchased from him.

POSSIBLE QUESTIONS
PART-A
Multiple Choice Questions
Online Quiz

PART-B

1. What is factoring?
2. What is bill discounting?
3. Define credit financing.
4. Define Forfeiting
5. What is a bill of exchange?

PART-C

1.Discuss the role of Factoring in India.

2.Differentiate between Factoring and Forfeiting.

3. Describe the present state of Forfeiting in India.

4. What do you mean by bill of exchange? Write in detail the steps involved in it

5. Differentiate between Factoring and Discounting.

6. Explain the benefits of Factoring.

7. Narrate the various benefits of forfeiting in India?

8. Elaborate the various identified drawbacks of Forfeiting in India

9.State in detail the various functions of Factoring?

10. Elaborate the various types of Factoring.

.

PART –D

Mr. VikasMehra was the Chairman of IBM Bank. The bank was earning good profits. Shareholders were happy as the bank was paying regular dividends. The market price of their shares was also steadily rising. The bank was about to announce the taking over of 'UK Bank'. Mr. VikasMehra knew that the share price of IBM Bank would rise on this announcement. Being a part of the bank, he was not allowed to buy shares of the bank. He called one of his rich friends Mukand and asked him to invest Rs. 4 crores in the shares of his bank promising him the capital gains.As expected, after the announcement, the share prices went up by 50% and the market price of Mukand's shares was now Rs. 6 crores. Mukand earned a profit of Rs. 2 crores. He gave Rs. 1 crore to VikasMehra and kept Rs. 1 crore with him. On regular inspection and by conducting enquiries of the brokers involved, the Securities and Exchange Board of India (SEBI) was able to detect this irregularity. SEBI imposed a heavy penalty on VikasMehra.

Quoting lines from the above paragraph, identify and state any two functions performed by the SEBI in the above case.

KARPAGAM ACADEMY OF HIGHER EDUCATION						
Department of Management						
Unit IV- LEASING-Multiple Choice Questions- Each Question Carry ONE Mark						
S.No	**Questions**	**Opt 1**	**Opt 2**	**Opt 3**	**Opt 4**	**Answer**
1	The term ------------------ refers financial investment in a highly risky and growth oriented venture with the objective of earning a high rate of return.	Venture Capital	Merchant Banking	Leasing	Hire Purchase	Leasing
2	Where 2 persone enter into agreement, whreby the lessor agrees to provide assets or equipments for use by the lessee over a period of time for which the lessee agrees to pay a consideration reglarly	Leasing	Hire Purchase	Instalment	Loan	Leasing
3	______ is a persone who owns and finances the purchase of the assets.	Lessor	Lessee	Payee	Acceptor	Lessor
4	The initial period of the lease agreement is called as ___________ period	Primary	Secoundary	Intermediary	Tenure	Primary
5	The period after renewal of agreement is called as __________ peiod	Primary	Secoundary	Intermediary	Tenure	Secoundary

6	Income Tax Act 1961 shall not allow any ___________ of investement in leasing business	investement Allowance	Benefits of Investement	Exemptions	Charge	Exemptions
7	______________ is a short term lease of an asset	Operating	Financial	Imported	Cross border	Operating
8	Which transfers to a lease that all risks and rewards incident to ownership of an asset	Financial	Operating	Sale & Lease Back	Sale Aid Lease	Financial
9	Import of capital assets is financed by foreign currency loans, rupee loans, or owner's equity are termed as	Imported	Financial	Operating	Sale Aid Lease	Imported
10	A firm sells an asset to another firm and then continues to use the same asset by getting it on lease from the other firm is	Sale and Lease Back Lease	Specialised Service Lease	Cross Borde Lease	Imported Lease	Sale and Lease Back Lease
11	Leasing across National frontiers are said to be	Cross Border Lease	Sale Aid Lease	Sale and Lease Back	Imported Lease	Cross Border Lease

12	Institutios engaged in leasing includes	Public Sector	Private Sector	Both	All Bankers	Both
13	_______ is a person who obtains from the lessor, the rights to use the asset for a periodical rental payment for an agreed peiod to time	Lessee	Lessor	Leasing	Period	Lessee
14	It is an financing arrangment that provides a firm with the advantage of using an asset withouit owning it, may be termed as _______	Lessor	Leasing	Lessee	Aggreement	Leasing
15	The Parties, Asset, Term and Lease Rentals are the characteristics of	Leasing	Lessor	Lessee	Aggreement	Leasing
16	International Accouting Standards (IAS) No. 17 speaks about	Lease	Financial Lease	Operating Lease	Lease Agreement	Lease
17	A Financial Lease is _______________ in nature	Cancelable	Non-Cancelable	Both	Based on agreement	Non-Cancelable

18	Full Payment Lease and True Lease are the _____ variants of Financial Lease	Two	methods	factors	parameters	Two
19	Leasing for consumer durables such as televisions, refriderators are said to be	Consumer Leasing	Financial Lease	Operating Lease	Leveraged Lease	Consumer Leasing
20	A lease is said to be very long tenure lease applicable to immovable properties is said to be	Conveyance type lease	Sale & Lease Back	Leveraged Lease	Operating Lease	Conveyance type lease
21	_________ lease which has zero residual value at the end of the lease period	Close end	Balloon	Open end	Swap	Balloon
22	Any leasing arrangment whereby the asset leased out is reverted to the lessor to known as ______________	Open End Leasing	Clsoe End Leasing	Swap	Wrap	Clsoe End Leasing
23	The lessee is allowed to exchange equipment leased out whenever the orignal asset has to be sent to the lessor for some repair or maintenance	Swap	Wrap	Imported	Balloon	Swap

24	When lessee further sub-leases the asset to the end user retaining a fee and a share of he residual value is called	Swap	Import	Wrap	Balloon	Wrap
25	Lessors, Lessees, Lease Brokers, Lease Financiers are the participants of	Leasing Industry	HP Industry	JV Industry	Instalment	Leasing Industry
26	Lease Selection, Orde and Delivery, Lease Contract, Lease Period, are the participnats of	Leasing Process	HP Industry	JV Industry	Instalment	Leasing Process
27	Both parties sign a lease agreement setting out the details fo the terms of the lease contract is called	Contract	Lease Contract	Business Contract	Venture Contract	Lease Contract
28	The term of lease period is said to be _____________ period	Lease	Lessee	Lessor	Leasing	Lease
29	Lease ______ constitue the consideration payable by the lessee as specified in the leaase transactions	Lessor	Rentals	Lessee	Leasing	Rentals

30	A financial lease is also called as ____________	Capital	Current	Revenue	TRUE	Capital
31	The advantage of having deprectiaton and Tax benefit twice such a concept is called as	Double Dip	Triple Dip	Cross Borde Lease	Operating Lease	Double Dip
32	Substance Test, Full Payment Test, Transfer of Title Test and Lease Term Test said to be a test of	Financial	Operating	International	Balloon	Financial
33	Lease brokers are the intermediaries betweeen the lessors and lesses who help find a suitable lessor for a prospective lessee and vice versa is	Lease Brokers	Lessee Brokers	Lessor Broker	Lease Agreement	Lease Brokers
34	Leasing Process includes Lease Selection, Order & Dellivery, Lease Contract and _________	Lease Period	Lease Contract	Lease Agreement	Financiers	Lease Period
35	Tax shield on depreciation, Tax shield on lease rentals and tax shield on lease rentals are financial implications of	Lessee	Lessor	Leasing	All the three	Lessee

36	Cost of asset minus Down Payment / Number of Instalments is	SPR	EMI	RBM	DBM	SPR
37	Parties to a lease agreement includes	Lessor	Lessee	Both A & B	Buyer	Both A & B
38	In ___________ leasing the lessee is allowed to exchange equipment leased out whenever the origial asset has to be sent to the lessor for some repair and maintenance	Swap	Wrap	Improt	Balloon	Swap
39	ELA(UK), Pandey.I.M (1986), IAS17, Hubbard (1980) Van Horne (1969) all ___________ Leasing	Defined	Committee on	Commission on	Explained	Defined
40	A dry lease provides only for financing as well as ____________ and servicing with aricraft industry	Fuel	Repair	Financing	Others	Fuel
41	Leasing company undertakes to relace out dated equipment with modern ones at specific rental terms is ______________	Upgrade	Wash	Capital	TRUE	Upgrade

42	_________________ leasing in which employer transfers all the workers to a leasing company then assigns back to the original employer under agreement	Employee Lease	Employer Lease	Percentage Lease	HR Lease	Employee Lease
43	Structure of a lease agreement do not include	Definition	Arbitration	Default of Lessee	Lease Transaction	Definition
44	One of the laws not affecting lease business	TOP-1882	Indian Stamp Act 1899	Indian Contract Act 1872	Cr.P.C Act	Cr.P.C Act
45	A blanket leasing covering numerous pieces of assets that estblishes an open ended contract with rates and terms for both equipment needed at present and for future	Master	Triple	Swap	Upgrade	Master
46	The entire lease rentals can be claimed on business expenditures by the lessee	Tax Planning	Tax Support	Tax Perquisites	Tax	Tax Planning
47	Disadvantages of Leasing shall not include	No Depreciation Allowance	Involve Higher Cost	Not a suitable mode of Finance	Low Cost of Operation	Low Cost of Operation

48	Chidambaram Group in 1973 approached Farouk Irani to float the __________ Lesing Company in Chennai	FLCI	First	FLCI-1979	1979	FLCI-1979
49	Structure of Leasing industry shall not include	Private Leasing	Pure Leasing	HP & Finance	Subsidiaries	Subsidiaries
50	Public Sector Leasing shall not includes the folloiwng financial institutions for Leasing	ICICI	NSIC	SCICI	ICAI	ICAI
51	Equipment Leasing Associaton (ESA) was formed in India during	1984	1985	1986	1987	1984
52	IRR, NPV and Pay Back method are the means of evalutaing a __________ lease	Finance	Equipment	Dry	Wet	Finance
53	Leasing involves a contractual relationship is which the owner (lessor) of an asset or property to a person called	Lessee	Lessor	Payee	Bailee	Lessee

54	Normally a contract leassee shall have	Payor, Payee	Bailor, Bailee	Leasee, Lessor	Payor, Bailor	Leasee, Lessor
55	A lessee may not be one the given business	Company	Cooperative	Government	Individual	Government
56	When an industrial house promotes a leasing company for the benefit of companies in the same group is known as	In-House Company	In-House Company Leasing	In-Leasing	Leasing	In-House Company Leasing
57	A Leasing company can earn profits from the ________ of operation	Year	Two Year	Three Year	Gestation period	Year
58	Lessee is not ________ allowed to claim depreciation, investement and other allowance, as the leased assets are owned by lessor	Not	Partly	Fully	Exempted	Not
59	Whether Indian Companies Act 1956 has role on lease transactions	Yes	NO	if Article admit	If Memorandum admit	Yes

60	Whether any Banking Agencies are attracted by Lease	RBI	SBI	Financial Institutions	Specialised Financial Institutions	RBI

UNIT-IV- LEASING

SYLLABUS

Unit IV

Leasing – History & Development – Concept & Classification – Types – Advantages – Disadvantages - Legislative Framework – Supplier, Lessor, Lessee Relationship – Sub Lease – Default & Remedies – Lease Evaluation in Lessee's and Lessor's point of view.

LEASING

A **lease** is a contractual arrangement calling for the lessee (user) to pay the lessor(owner) for use of an asset. Property, buildings and vehicles are common assets that are leased. Industrial or business equipment is also leased.

Broadly put, a lease agreement is a contract between two parties, the lessor and the lessee. The lessor is the legal owner of the asset; the lessee obtains the right to use the asset in return for regular rental payments. The lessee also agrees to abide by various conditions regarding their use of the property or equipment. For example, a person leasing a car may agree that the car will only be used for personal use.

The narrower term **rental agreement** can be used to describe a lease in which the asset is tangible property. Language used is that the user *rents* the land or goods *let* or *rented out* by the owner. The verb *to lease* is less precise because it can refer to either of these actions. Examples of a lease for intangible property are use of a computer program (similar to a license, but with different provisions), or use of a radio frequency (such as a contract with a cell-phone provider).

The term **rental agreement** is also sometimes used to describe a periodic lease agreement (most often a month-to-month lease) internationally and in some regions of the United States.

Leasing: Definitions, Types, Merits and Demerits

A "lease" is defined as a contract between a lessor and a lessee for the hire of a specific asset for a specific period on payment of specified rentals.

The maximum period of lease according to law is for 99 years. Previously land or real estate, mines and quarries were taken on lease. But now a day's plant and equipment, modem civil aircraft and ships are taken.

Definition:

(i) Lessor:

The party who is the owner of the equipment permitting the use of the same by the other party on payment of a periodical amount.

(ii) Lessee:

The party who acquires the right to use equipment for which he pays periodically.

Lease Rentals:

This refers to the consideration received by the lessor in respect of a transaction and includes:

(i) Interest on the lessor's investment;

(ii) Charges borne by the lessor. Such as repairs, maintenance, insurance, etc.;

(iii) Depreciation;

iv) Servicing charges.

At present there are many leasing companies such as 1st Leasing Company, 20th Century Leasing Company which are doing quite a lot of business through leasing, it has become an important financial service and a lucrative avenue of making sizable profits by leasing companies.

Types of Leases:

The different types of leases are discussed below:

1. **Financial Lease:**

This type of lease which is for a long period provides for the use of asset during the primary lease period which devotes almost the entire life of the asset. The lessor assumes the role of a financier and hence services of repairs, maintenance etc., are not provided by him. The legal title is retained by the lessor who has no option to terminate the lease agreement.

1. The principal and interest of the lessor is recouped by him during the desired playback period in the form of lease rentals. The finance lease is also called capital lease is a loan in disguise. The lessor thus is typically a financial institution and does not render specialized service in connection with the asset.

2. Operating Lease:

It is where the asset is not wholly amortized during the non-cancellable period, if any, of the lease and where the lessor does not rely for is profit on the rentals in the non- cancellable period. In this type of lease, the lessor who bears the cost of insurance, machinery, maintenance, repair costs, etc. is unable to realize the full cost of equipment and other incidental charges during the initial period of lease.

The lessee uses the asset for a specified time. The lessor bears the risk of obsolescence and incidental risks. Either party to the lease may termite the lease after giving due notice of the same since the asset may be leased out to other willing leases.

3. Sale and Lease Back Leasing:

To raise funds a company may-sell an asset which belongs to the lessor with whom the ownership vests from there on. Subsequently, the lessor leases the same asset to the company (the lessee) who uses it. The asset thus remains with the lessee with the change in title to the lessor thus enabling the company to procure the much needed finance.

4. Sales Aid Lease:

Under this arrangement the lessor agrees with the manufacturer to market his product through his leasing operations, in return for which the manufacturer agrees to pay him a commission.

5. Specialized Service Lease:

In this type of agreement, the lessor provides specialized personal services in addition to providing its use.

6. Small Ticket and Big Ticket Leases:

The lease of assets in smaller value is generally called as small ticket leases and larger value assets are called big ticket leases.

7. Cross Border Lease:

Lease across the national frontiers is called cross broker leasing. The recent development in economic liberalisation, the cross border leasing is gaining greater importance in areas like aviation, shipping and other costly assets which base likely to become absolute due to technological changes.

8. Merits of Leasing:

(i) The most important merit of leasing is flexibility. The leasing company modifies the arrangements to suit the leases requirements.

(ii) In the leasing deal less documentation is involved, when compared to term loans from financial institutions.

(iii) It is an alternative source to obtain loan and other facilities from financial institutions. That is the reason why banking companies and financial institutions are now entering into leasing business as this method of finance is more acceptable to manufacturing units.

(iii) The full amount (100%) financing for the cost of equipment may be made available by a leasing company. Whereas banks and other financial institutions may not provide for the same.

(iv) The 'Sale and Lease Bank' arrangement enables the lessees to borrow in case of any financial crisis.

(v) The lessee can avail tax benefits depending upon his tax status.

9. Demerits of Leasing:

(i) In leasing the cost of interest is very high.

(v) (ii) The asset reverts back to the owner on the termination of the lease period and the lesser loses his claim on the residual value.

1. Leasing is not useful in setting up new projects as the rentals become payable soon after the acquisition of assets.

2. The lessor generally leases out assets which are purchased by him with the help of bank credit. In the event of a default made by the lessor in making the payment to the bank, the asset would be seized by the bank much to the disadvantage of the lessee.

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

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

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

The lessor has the duty to deliver the asset to the lessee, to legally authorise the lessee to use the asset, and to leave the asset in peaceful possession of the lessee during the currency of the agreement.

4. The lessor has the obligation to pay the lease rentals as specified in the lease agreement, to protect the lessor's title, to take reasonable care of the asset, and to return the leased asset on the expiry of the lease period.

Contents of a lease agreement:

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

(2) Description of the lessor, the lessee, and the equipment.
(3) Amount, time and place of lease rentals payments.
(4) Time and place of equipment delivery.
(5) Lessee's responsibility for taking delivery and possession of the leased equipment.

(6) Lessee's responsibility for maintenance, repairs, registration, etc. and the lessor's right in case of default by the lessee.
(7) Lessee's right to enjoy the benefits of the warranties provided by the equipment manufacturer/supplier.
(8) Insurance to be taken by the lessee on behalf of the lessor.
(9) Variation in lease rentals if there is a change in certain external factors like bank interest rates, depreciation rates, and fiscal incentives.
(10) Options of lease renewal for the lessee.
(11) Return of equipment on expiry of the lease period.
(12) Arbitration procedure in the event of dispute.

The Lessor

The lessor is the company supplying the finance for the equipment being leased. It is the lessor who maintains ownership regardless of lease type and they have very few obligations under the lease, other than to provide you with the right to use the equipment without any interference.

Just like dating, there are good and bad lessors and before you enter into a long-term contract with one, you need to know that they are best suited to your operational and financial requirements. Some lessors specialise in specific equipment, others deal more generally with all asset types and lease structures.

Lessors come in many guises; banks or subsidiaries of banks, others are linked to or part of equipment suppliers and there are also a plethora of independent leasing companies specialising in particular market sectors (for example IT or Healthcare).

Leasing has historically been driven by local tax and local legislative rules and has therefore been "localised" within each country or region, however as business has "globalised" so too have some lessors and it is now possible and realistic to contemplate global lease arrangements with certain lessors.

With so many fish in the sea available for lessees, it is important to keep a clear head and do some research before falling head over heels for the wrong lessor. Many lessees have suffered more than a broken heart when negotiating with an unforgiving lessor, costing them dearly with restrictive terms or complex clauses. However, with the right lessor, companies are able to flourish through competitive lease rates and well negotiated terms and have a mutually beneficial relationship that leads to a long lasting love.

The Lessee

As the lessee, your payments allow you the right to use the equipment under lease for your business, provided you stick to the guidelines and regulations included in the lease agreement. As the lessor owns the equipment, the lessee is effectively borrowing someone else's equipment, so you are responsible for the following – although some of these features will vary depending on the type of lease: -

- Keeping the equipment in an acceptable condition
- Using it only for the purpose that it was designed for
- Organising end of lease arrangements
- Making sure the lessor is aware of its location at all times
- Paying the rentals on time and;
- Any other tasks agreed in the lease documentation

In most situations, it is the lessee's responsibility to choose the correct asset to meet the business needs. Lessors will rarely take responsibility for the suitability of the asset or whether it works - it is down to the lessee to plan for the different requirements your operational users may need.

Whether IT technology that needs regular updating, machinery that may be prone to damages or storage containers that need to be transported globally, it is the lessee's responsibility to negotiate the required clauses as part of the agreement.

The perfect lease, like the perfect relationship, is about finding the right balance between what you as a lessee would like to include and what realistically can be achieved. While you may ideally prefer to be able to end your finance lease whenever you'd like with no early termination fees, realistically, this may raise the lease rate. Once you have a common understanding that a lease is an agreement between you both, not a competition, then you are on track to getting the best lease.

If you are looking for the perfect leasing relationship for your lease portfolio, you may wish to talk to Inner vision. Like Cupid's bow, Inner vision has its own specialised leasing software and expert consultancy, which has already helped many lessees manage their lease agreements, allowing them to keep in control of their contractual obligations and attain the best lease terms for their operational requirements.

What is a 'Sublease'

A sublease is a real property rental agreement between an original tenant and a new tenant. The most common type of lease arrangement is between the landlord who owns the property and a tenant. If that tenant finds him or herself unable to continue meeting the terms of their lease, they may opt to create a sublease if the landlord allows it. The sub lessee is subject to the same rental terms that the original lessee was subject to. Subleases can be executed for both residential and commercial properties.

Because a lease is generally for a predefined term, situations can arise that make it difficult or impossible for the original tenant to complete the lease term. For example, if Sebastian is renting an apartment in Chicago with a 12-month lease and in month four he receives a job offer in Boston, he may decide to sublease his apartment to another tenant for the remaining eight months. The sublease means that Sebastian can accept the job and move

(b) he doesn't have to pay expensive fees to get out of his lease or pay rent on two apartments. The landlord also benefits because he receives all 12 rent payments and doesn't have to find a replacement tenant. The sublease arrangement also means that Sebastian retains an interest in the apartment, so if he decides to move back to Chicago, he may be able to renew his lease and get his old apartment back. **Default and Remedies**

Tenant Default. The occurrence of any one of the following events shall constitute a default of Tenant:

The abandonment of the Premises by Tenant for a period of thirty (30) consecutive days;

Failure to pay Rent or any other monies due and continuing for a period of ten (10) days after the same is due;

A general assignment by Tenant for the benefit of creditors;

The filing of a voluntary petition in bankruptcy by Tenant;

Receivership, attachment, or other judicial seizure of substantially all of Tenant s assets on the Premises;

Failure of Tenant to execute and deliver to Landlord any estoppel certificate, subordination agreement, or lease amendment within the time periods and in the manner required;

An assignment or sublease, or attempted assignment or sublease, of this Lease or the Premises by Tenant, unless, such assignment or sublease is expressly conditioned upon Tenant having received Landlord s consent;

Failure in the performance of any of Tenants agreements or obligations in this lease;

Chronic delinquency by Tenant in the payment of Rent, or any other periodic payments required to be paid by Tenant under this Lease.

Landlord Default. The following events shall constitute a default of Landlord:

Fails to perform or observe any condition or obligation of this Lease to be performed by Landlord within thirty (30) days following written notice to Landlord of such failure, provided that

If the nature of such default reasonably requires more than thirty (30) days, Landlord shall not be in default hereunder if Landlord has promptly commenced such cure and is diligently pursuing the same, and;

If the nature of such default poses an imminent danger to persons or property, then such period of time shall be a reasonable period of time in light of the circumstances.

Landlord Remedies. In the event of Tenant default, Landlord has the following remedies:

Terminate this Lease;

Re-enter the Premises, terminate Tenant's right of possession of the Premises without terminating this Lease, and re-let all or any part of the Premises;

Cure such event of default for Tenant at Tenant's expense;

Apply the Security Deposit toward unpaid monetary obligations of Tenant;

Pursue any other remedy now or hereafter available to Landlord under the law

Tenant Remedies. In the event of Landlord default, Tenant has the following remedies:

Use any remedies available to it at law;

Cure the default on behalf of Landlord, and the reasonable costs of such cure shall be paid to Tenant by Landlord upon written demand.

Mitigation. Both parties agree to mitigate their damages upon default.

The lease evaluation from the point of view of the lessor aims at ascertaining whether to accept a lease proposal or to choose from alternative proposals. As in the case of the evaluation by a lessee, the appraisal method used is the discounted cash flow technique based on the lessor's cash flows. The leaser related cash flow from his angle consists of (a) outflows in terms of the initial investment/acquisition cost of the asset at the inception of the lease; income tax on lease payments, sales tax on lease transaction, if any; lease administration expenses such as rental collection charges, expenses on suits for recovery and other direct cost, and so on, (b) inflows such as lease rentals, management fee, tax shield on depreciation residual value and security deposit, if any, and so on. This section illustrates lease evaluation from the point of view of a lessor and includes aspects such as break-even rental for the lessor, negotiation and fixation of lease rentals.

Financial Evaluation of Leasing

Financial Evaluation of Leasing: Way # 1.

Lessee's Point of View:

(Lease or Buy/Lease or Borrow Decisions):

Once a firm has evaluated the economic viability of an asset as an investment and accepted/selected the proposal, it has to consider alternate methods of financing the investment. However, in making an investment, the firm need not own the asset. It is basically interested in acquiring the use of the asset.

Thus, the firm may consider leasing of the asset rather than buying it. In comparing leasing with buying, the cost of leasing the asset should be compared with the cost of financing the asset through normal sources of financing, i.e., debt and equity.

Since, payment of lease rentals is similar to payment of interest on borrowings and lease financing is equivalent to debt financing, financial analysts argue that the only appropriate comparison is to compare the cost of leasing with that of cost of borrowing. Hence, lease financing decisions relating to leasing or buying options primarily involve comparison between the cost of debt-financing and lease financing.

The evaluation of lease financing decisions from the point of view of the lessee involves the following steps:

1. Calculate the present value of net-cash flow of the buying option, called NPV (B).
2. Calculate the present value of net cash flow of the leasing option, called NPV (L)
3. (iii) Decide whether to buy or lease the asset or reject the proposal altogether by applying the following criterion:
4. (a) If NPV (B) is positive and greater than the NPV (L), purchase the asset.
5. (b) If NPV (L) is positive and greater than the NPV (B), lease the asset.

(c) If NPV (B) as well as NPV (L) are both negative, reject the proposal altogether.

Since many financial analysts argue that the lease financing decisions arise only after the firm has made an accept-reject decision about the investment; it is only the comparison of cost of leasing and borrowing options.

The following steps are involved in such an analysis:

(i) Determine the present value of after-tax cash outflows under the leasing option.

(ii) Determine the present value of after-tax cash outflows under the buying or borrowing option.

(iii) Compare the present value of cash outflows from leasing option with that of buying/borrowing option.

(iv) Select the option with lower presented value of after-tax cash outflows..

Illustration 1:

A limited company is interested in acquiring the use of an asset costing Rs. 5,00,000. It has two options:

(i) To borrow the amount at 18% p.a. repayable in 5 equal installments or

(ii) To take on lease the asset for a period of 5 years at the year end rentals of Rs. 1,20,000.

The corporate tax is 50% and the depreciation is allowed on w.d.v. at 20%. The asset will have a salvage of Rs. 1,80,000 at the end of the 5th year.

You are required to advise the company about lease or buy decision. Will decision change if the firm is allowed to claim investment allowance at 25%?

Note:

(1) The present value of Re. 1 at 18% discount factor is:

1st year – .847

2nd year – .718

3rd year – .609

4th year – .516

5th year – .437

(2) The present value of an annuity of Re. 1 at 18% p.a. is Rs. 3.127.

Solution

***(i)* Calculation of loan instalment**

$$\text{Loan Instalment} = \frac{\text{Amount of Loan}}{\text{P.V. Factor of Annuity}} = \frac{5{,}00{,}000}{3.127}$$

= ₹ 1,59,898 appx.

***(ii)* Schedule of Loan Payment**

Year	Loan Balance at beginning of the year (₹)	Loan Instalment (₹)	Interest Payment (₹)	Principal Payment (₹)	Loan Balance at the end of the year (₹)
1.	5,00,000	1,59,898	90,000	69,898	4,30,102
2.	4,30,102	1,59, 898	77,418	82,480	3,47,622
3.	3,47,622	1,59,898	62,572	97,326	2,50,296
4.	2,50,296	1,59,898	45,053	1,14, 845	1,35,451
5.	1,35,451	1,59,832*	24,381	1,35,451	Nil

* The amount of loan instalment in the last year is different from the equal payments because of compensation for rounding error.

***(iii)* Calculation of Present Value of After-Tax Cash Outflows under Borrowing/Buying Option**

Year end	Loan Instalment (₹)	Tax Saving on Interest (₹)	Tax Saving on Dep. (after-tax) (₹)	Tax Saving on Total (₹)	Net cash Outflow (₹)	P.V. factor at 18%	P.V. of after tax Net cash Outflow (₹)
Col. 1	2			3	4 = 2–3	5	6
1.	1,59,898	45,000	50,000	95,000	64,898	.847	54,969
2.	1,59,898	38,709	40,000	78,709	81,189	.718	58,294
3.	1,59,898	31,286	32,000	63,286	96,612	.609	58,837
4.	1,59,898	22,527	25,600	48,127	1,11,771	.516	57,674
5.	1,59,832	12,190	20,480	32,670	1,27,162	.437	55,570
						Total :	2,85,344
			Less : P.V. of salvage at the end of 5th year (1,80,000 × .437)				78,660
							2,06,684

***(iv)* Calculation of Present Value of After-Tax Cash Outflows under Lease Option**

Year end	Lease Rental (₹)	Tax Savings on Lease Rent (₹)	After-Tax Cash Outflow (₹)	P.V. Annuity Factor at 18% (₹)	Total P.V. of Cash Outflows (₹)
1–5	1,20,000	60,000	60,000	3.127	1,87,620

(v) Evaluation:

As the present value of after-tax cash outflows under the leasing option is lesser than the present value of after-tax cash outflows of the buying option, it is advisable to take the asset on lease.

(vi) Decision if Investment Allowance is allowed:

In case Investment Allowance is allowed on purchase of asset the total of present value of net cash outflows will decrease by the present value of tax savings on investment allowance as below:

	₹
Investment Allowance :	
(allowed at the end of 1st year) $5,00,000 \times \frac{25}{100}$	1,25,000
Tax Savings (50%)	62,500
P.V. Factor at the end of year 1	.847
P.V. of Tax Savings on Investment Allowance	52,938
Hence, P.V. of Cash Outflows in Buying Option shall be = ₹ 2,06,684-52,938	1,53,746

In that case, the P.V. of cash outflows under buying option shall be lesser than the P.V. of cash outflows under leasing option and the company should buy the asset.

Financial Evaluation of Leasing: **Way # 2.**

Lessor's Point of View:

The financial viability of leasing out an asset from the point of view of lessor can be evaluated with the help of the two time adjusted methods of capital budgeting:

(a) Present Value Method

(b) Internal Rate of Return Method.

(a) Present Value Method:

This method involves the following steps:

(i) Determine cash outflows by deducing tax advantage of owning an asset, such as investment allowance, if any.

(ii) Determine cash inflows after-tax as below:

(iii) Determine the present value of cash outflows and after tax cash inflows by discounting at weighted average cost of capital of the lessor.

(iv)Decide in favour of leasing out an asset if P.V. of cash inflows exceeds the P.V. of cash outflows, i.e., if the NPV is positive; otherwise in case N.P.V. is -negative, the lessor would lose on leasing out the asset

	₹
Lease Rental (say)	1,00,000
Less : Depreciation (say)	20,000
Earnings Before Tax (EBT)	80,000
Less : Tax (say 50%)	40,000
Earnings After Tax (EAT)	40,000
Add : Depreciation	20,000
Cash Inflows After Tax (CFAT)	60,000

The above technique has been explained with the help of the following example.

Illustration 2:

From the information given below, you are required to advise about leasing out of the asset:

Cost of Equipment	₹ 4,00,000	
Average Cost of Capital to the lessor	12%	
Depreciation (Allowable)	20%	on original cost
Expected Life of Asset	5	years
Salvage Value	Nil	
Lease Rent payable at the end of each of 5 years	₹ 1,50,000	
Corporate Tax (applicable to lessor)	50%	
P.V. of an annuity of Re. 1 for 5 years at 12% is ₹ 3.605		

Solution

		(₹)
(i)	**Calculation of Cash Outflow**	
	Cost of Equipment	4,00,000
	Less : Tax Advantage, if any	Nil
	Cash Outflow	4,00,000

		(₹)
(ii)	**Calculation of After-Tax Cash Inflows**	
	Lease Rental	1,50,000
	Less : Depreciation	80,000
	Earnings Before Tax (EBT)	70,000
	Less : Tax at 50%	35,000
	Earnings After Tax (EAT)	35,000
	Add : Depreciation	80,000
	Cash Inflows After Tax (CFAT)	1,15,000

(iii) **Calculation of Present Value (P.V.) of Cash Outflows**

Year (₹)	*Cash Outflow* (₹)	*P.V. Discount Factor at 12%*	*P.V. of Cash Outflow* (₹)
0	4,00,000	1.00	4,00,000

(iv) **Calculation of P.V. of Cash Inflows**

Year	*Cashflow After Tax (CFAT)* ₹	*P.V. Annuity Discount Factor at 12%*	*P.V. of Cash Inflows* ₹
1-5	1,15,000	3.605	4,14,575

(iv) **Calculation of Net Present Value**

	₹
Present value of Cash Inflows	4,14,575
Less : P.V. of Cash Outflows	4,00,000
Net Present value of Cash flows	14,575

Since the present value of cash inflows is more than the present value of cash outflows or says N.P.V. is positive, it is desirable to lease out the asset.

(b) Internal Rate of Return Method:

The internal rate of return can be defined as that rate of discount at which the present value of cash-inflows is equal to the present value of cash outflows.

It can be determined with the help of the following mathematical formula:

$C = A_1/(1+r) + A_2/(1+r)^2 + A_3/(1+r)^3 + \dots \dots \dots \dots + A_n/(1+r)^n$
where, C = Initial Outlay at time Zero.
$A_1, A_2, \dots \dots \dots A_n$ = Future net cash flows at different periods.
2,3 …….. , = Numbers of years
r = Rate of discount of internal rate of return.
The Internal rate of return can also be determined with the help of present value tables.
The following steps are required to practice the internal rate of return method:
(1) Determine the future net cash flows for the period of the lease. The net cash inflows are estimated future net cash flows for the period of the lease. The net cash inflows are estimated future earnings, from leasing out the asset, before depreciation but after taxes.
(2) Determine the rate of discount at which the present value of cash inflows is equal to the present value of cash outflows. This may be determined as follows:
(a) When the annual net cash flows are equal over the life of the asset:
Firstly, find out Present Value Factor by dividing initial outlay (cost of the investment) by annual cash flow, i.e., Present Value Factor = Initial Outlay/Annual Cash Flow. Then, consult present value annuity tables with the number of year equal to the life of the asset and find out the rate at which the calculated present value factor is equal to the present value given in the table.
Illustration 3:

Initial Outlay	₹ 50,000
Life of the Asset	5 years
Estimated Annual Cash-flow	₹ 12,500
Calculate the Internal Rate of Return.	

Solution:

Present Value Factor $= \frac{\text{Initial Outlay}}{\text{Annual Cash Flow}}$

$= \frac{50{,}000}{12{,}500} = 4.$

Consulting Present Value Annuity Tables for 5 years periods at Present Value Factor of 4. (For Present Value Tables see Appendix A and B given at the end of the book)

Internal Rate of Return =8% approx.

(as seen from the table that at 8% for 5 year period, the present value is 3.9927 which is nearly equal to 4.)

(b) When the annual cash flows are unequal over the life of the asset:
In case annual cash flows are unequal over the life of the asset, the internal rate of return cannot be determined according to the technique suggested above. In such cases, the internal rate of return is calculated by hit and trial and that is why this method is also known as hit and trial yield method.

We may start with any assumed discount rate and find out the total present value of all the cash flows by consulting present value tables.

The so calculated total present value of cash inflows as compared with the present value of cash outflows which is equal to the cost of the initial investment where total investment is to be made in the beginning. The rate, at which the total present value of all cash inflows equals the initial outlay, is the internal rate of return. Several discount rates may have to be tried until the appropriate rate is found.

The calculation process may be summed up as follows.

(i) Prepare the cash flow table using an arbitrary assumed discount rate to discount the net cash flow to the present value.
(ii) Find out the Net Present Value by deducting from the present value of total cash flows calculated in (i) above the initial cost of the investment.
(iii) If the Net Present Value (NPV) is positive, apply higher rate of discount.
(iv) If the higher discount rate still gives a positive net present value, increase the discount rate further until the NPV becomes negative.
(v) If the NPV is negative at this higher rate, the internal rate of return must be between these two rates:
(3) Accept the proposal if the internal rate of return is higher than or equal to the minimum required rate of return, i.e. the cost of capital or cut off rate.
(4) In case of alternative proposals select the proposal with the highest rate of return as long as the rates are higher than the cost of capital or cut-off rate.

Illustration 4:
Initial Investment – Rs. 60,000
Life of the Asset – 4 years
Estimated Net Annual Cash Flows:

	₹
1st Year	15,000
2nd Year	20,000
3rd Year	30,000
4th Year	20,000

Compute the internal rate of return and also advise the lessor about the leasing out decision if his expected minimum rate of return is 15%.

Note: Present Value Factor at various rates of discount.

P.V. Cash Flows Table at Various Assumed Discount Rates of 10%, 12%, 14% & 15%

Year	Annual Cash Flow ₹	Discount rate 10%		12%		14%		15%	
		P.V.F.	P.V. ₹	P.V.F.	P.V. ₹	P.V.F.	P.V. ₹	P.V.F.	P.V. ₹
1	15,000	.909	13,635	.892	13,380	.877	13,155	.869	13,035
2	20,000	.826	16,520	.797	15,940	.769	15,380	.756	15,120
3	30,000	.751	22,530	.711	21,330	.674	20,220	.657	19,710
4	20,000	.683	13,660	.635	12,700	.592	11,840	.571	11,420
			66,345		63,350		60,595		59,285

(1)The present value of cash flows at 14% rate of discount is Rs. 60,595 and at 15% rate of discount it is t 59,285. So the initial cost of investment which is Rs. 60,000 falls in between these two discount rates. At 14% the NPV is+ 595 but at 15% the NPV is – 715, we may say that IRR = 14.5% (approx).

(2) As the IRR is less than the minimum required rate of return, the lessor should not lease out the asset.

XXXXXX

POSSIBLE QUESTIONS

PART-A

Multiple Choice Questions

Online Quiz

PART-B

1. Define Leasing.
2. Describe the procedure for leasing.
3. Write the entities of Direct Lease.
4. Write any four advantages of lease financing.
5. Describe the problem of leasing

PART-C

1. What are the limitations of lease financing?
2. What are the types of leasing?
3. Discuss the advantages and disadvantages of leasing.
4. Explain lessee and lessor relationship in banking point of view.
5. Write the history and development of leasing.

PART –D

Harsh works as a manager in a software company. He opened a Demat account with a broking house in order to trade in securities with the money he received as his first performance bonus. Since then he has been very active in stock trading under the guidance of a stock broker. However, when he was hospitalized for a few days this year, his wife received several calls from the stock broker for permission to transact on Harsh's behalf. Though she told him to wait till her husband had recovered, the stock broker went ahead and executed the transactions. When Harsh got home from hospital, he discovered that the unauthorized transactions had led to a loss for him.

Harsh complained to the broking house, but they claimed he had authorized the transactions. Keeping in new, the guidelines issued by the National Stock Exchange that he had read in the national newspaper Harsh demanded proof and threatened to file a complain. Since, the broking house had no evidence that the deals had been authorized they made good the loss that Harsh had incurred due to the transaction.

In the context of the above case

1. What is a Demat account?
2. Who is acting as the depository participant for Harsh?
3. Name the document that is illegally enforceable and helps to settle the claims between the investor and the broker

KARPAGAM ACADEMY OF HIGHER EDUCATION						
Department of Management						
Unit V- Nature of HIRE PURCHASE Choice Questions- Each Question Carry ONE Mark						
S.No	**Questions**	**Opt 1**	**Opt 2**	**Opt 3**	**Opt 4**	**Answer**
1	Hire Purchase Act was passed in the year	1952	1962	1972	1975	1972
2	Banking Regularion Act 1949 has amended in 1990 in order to permit commercial banks to enter into	Hire Purchase Business	Installment Business	HP & Instalment	Lesing	Hire Purchase Business
3	Any transaction of finance whreby goods are bought and sold as per terms and conditins	Instalment	HirePurchase	Both a & b	Leasing	HirePurchase
4	Right to Protection, Notice, Repossesson, Statement, Excess Amount are the rights under HP Act 1972 for	Hirer	Payee	Vendor	In Instalment	Hirer
5	Add-on Rate, Flat rate of interst, Effective Rate of Interst are the rate charges _________	On HP	On Installment	On Loan	Others	On HP

6	Effectove rate of interst, Sum of years digits and Strainght line method are the ways of calculating	Interst	Dividend	Principal	Principal +Interst	Interst
7	Method of reporting of hire purchase includes	Disclosure of Hirer Books	Disclosure of Hire Vendor Books	Both A & B	Installment	Both A & B
8	Which of these is not a credit rating agency?	Moodys	Standard & Poor?s	Price water house	ICRA	ICRA
9	C.R.A. is banking parlance stands for	Credit Rating Assoucatin	Credit Rating Agency	Credit Risk Assessemente	Credit Rating Appraisal	Credit Rating Agency
10	India Index Services & Products Limited (IISL) is a joint venture between two entities	NSE and CRISIL Ltd.	NSE and ICRA Ltd.	BSE and CARE Ltd.	BSE and CRISIL Ltd.	NSE and CRISIL Ltd.
11	Credit rating agencies determine interest rates on debt securities	TRUE	FALSE	Difficult to say	Depends	FALSE

12	SEBI gives credit rating to securities issued in the capital market	Difficult to say	FALSE	TRUE	At times	FALSE
13	Mutual funds can offer guaranteed returns	TRUE	FALSE	Not often	At Times	FALSE
14	A mutual fund scheme; with a entry load will have its sale price higher than its NAV.	TRUE	Always True	Somttimes True	Not at all	TRUE
15	Mutual funds range from very conservative to extremely speculative investments	Always True	TRUE	False	Always False	TRUE
16	Global Credit Rating Agencies does not include	Moody's	S&P	DCR	CARE	CARE
17	CRISIL was born during the year	1987	1991	1994	1996	1987

18	Followng are the benefits of issuers due to credit rating agencies	Wider Invetor Base	Bench Mark	Index of Faith	Regulators	Regulators
19	One of the parameters shall not be an major issue of credit rating	Continuous Monitoring	Grade Surveillance	Rating Ceilling	Specivicity	Specivicity
20	Moodys Invetors Service was launched from	Canada	USA	India	Japan	USA
21	First domestic credit rating agencies was started was	ICRA	CARE	CRISIL	Duff & Phelps	CRISIL
22	Credit Rating has been made mandatory in India by ___________ agencies	SEBI & SBI	RBI & Sate Govt.	ICA & MOP	GOI & CLB	GOI & CLB
23	For the purpose of Credit Rating Symbols the following are the long term debt instruments	Debenture, Shares	Bonds, Preference Shares	Equity & Preference Shares	Debentures & Bonds	Debentures & Bonds

24	The sign "+" and "-" are used by one of the rating agencies	ICRA	CRISIL	CARE	S&P	CRISIL
25	The Concept of credit rating system was originated in US _______ Great Depression	After	Before	During	Not Connected with	After
26	Credit Rating is made to ________________ instruments	Group of	Specific	Combinations of	Based on necessity	Specific
27	The rating is primarily aimed at furnishing guidance to	Investors	Creditors	Both	Market	Both
28	Do the rating agencies provide any guarantee to the investement community	Yes	No	Recommends	Based on risk	No
29	For the purpose of calculating rating symbols the following are the technqiues used	Quantitative	Qualitative	Both	Financial Data	Both

30	Does rating agencies applies any professinal competency in doing calculations	Yes	At times	Never	Necessity arises	Yes
31	Credit Rating agencies fix interest rates on bonds or debentures issued by companies.	FALSE	TRUE	At Times True	Depends	TRUE
32	Credit Rating evaluates the ability to ________________ the principal and interst of the issuing company	Repurhase	Repay	Redeemption Capacity	Evaluate	Repay
33	Whether Rating is made compulsory for all corporate bodies intend to raise funds	TRUE	Need Arises	To prove the strength	All the factors	TRUE
34	Rating reduces the dependence on brokers and merchant bankers	100% True	Supprts Investors	Not at all times	Additional Gaurantee	100% True
35	DO credit rating is a way of collecting information at low cost by the investor	TRUE	FALSE	Not always	Sometime	TRUE

36	Time, Climatic, Labor Problems, Political, Geographical are ________ factors affecting rating	Factors	Parameters	Both	Demerits	Both
37	ICRA do not provides the following services	Rating & Information	Grading & Advisory	Evaluation	Option A & B	Evaluation
38	Corporate Goverance Rating is done by	CRISIL	ICRA	CARE	S&P	ICRA
39	ICRA mutual fund grading services shall not include	Coporate Reprots	Performance Grading	Credit Risk Grading	Market Risk Grading	Coporate Reprots
40	Credit Rating is an indicator to investors and _______ in determining the credit risk associated with debt instruments	Creditors	Debotors	Bankers	Lenders to the fund	Creditors
41	Whether rating is a compulsory for all corporate bodies intend to raise money	Yes	No	when need arises	Directions of CLB	Yes

42	Whether advisory services are considered in credit rating	Always Taken	Directions of CLB	Yes	No	Yes
43	For the purpose of Credit Rating Sergices, the Risk Management Practice include	Credit Risk	Market Risk	Operation Risk	As in a.b & c	As in a.b & c
44	CRISIL was sponspred by	ICICI	UTI	other financial isntitutions	ICICI	ICICI
45	ICRA does not provides ___________ services	Industry & Sector	Customised & Rating Profile	Corporate Analysis & Reports	Rating Services Only	Rating Services Only
46	Credit Rating is an _______________ by an independent prfessional organization	Opinion Expressed	Opinion Disexpressed	Opinion	Expression	Opinion Expressed
47	RBI and SEBI ___________ the eligibility criteria for financial instruments	Decide	Determines	Fixes	Do not determine	Determines

48	Credit Rating make more meaningful relationship ___________ quality of debt and yield from it.	between	nothing	related	often	between
49	Normally credit rating agencies divide the rating universe in to industry and instruments	TRUE	Yes	False	No	Yes
50	IDBI has promoted the _________ agency	CRISIL	CARE	ICRA	D & P	CARE
51	Codes are dissimilar in the case of __________	S & P	CRISIL	CARE	ICRA	S & P
52	Whether the rating agencies do fall under surveillance	No	Yes	Based on Necessity	If required	Yes
53	Investors, Issures, Buy-Sell side firms, Regulatory boards etc are the beneficiaries of	Banking	RBI	SEBI	Credit Rating	Credit Rating

54	Rating is an observation made by the outside concern regading the _____ capabilities of a firm	financial	administrative	productive	employee	Financial
55	Whether Equity are rated on par with other financial instruments	Recommended	Not Recommended	True	Yes	Yes
56	Credit Rating provides a __________ ranking of the credit quality of the debt instruments	Relative	Not Related	recmmends	FALSE	Relative
57	Request, Appointment of analytical team, Preliminary Research, Rating Committee, Appeal process constitutes	Financial Evaluation	Evaluation	Rating Process	Grading	Rating Process
58	Long term debentures, bonds and fixed deposits are having similar number of grades and subgrades in	India	USA	UK	Other Counrtires	India
59	Systematic Risk + Unsystematic Risk comprises of	Total Risk	Partial Risk	Individual Risk	Compound Risk	Total Risk

60	ONICRA is an rating agency in	India	UK	USA	European Countries	India

UNIT-V- HIRE PURCHASE

SYLLABUS

Unit V
Hire Purchase – Concept & Characteristics – Rate of Interest – Methods of reporting adopted for hire purchase transactions- Legal aspects – Tax implication frame work for Financial Evaluation – Credit Rating – Concept – Types – Advantages & Disadvantages – Credit Rating Process – Credit Rating Agencies

HIRE PURCHASE

Meaning:

Hire purchase is a method of financing of the fixed asset to be purchased on future date. Under this method of financing, the purchase price is paid in installments. Ownership of the asset is transferred after the payment of the last installment.

Features of Hire Purchase:

The main features of hire purchase finance are:

1. The hire purchaser becomes the owner of the asset after paying the last installment.

2. Every installment is treated as hire charge for using the asset.

3. Hire purchaser can use the asset right after making the agreement with the hire vendor.

4. The hire vendor has the right to repossess the asset in case of difficulties in obtaining the payment of installment.

Advantages of Hire Purchase:

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

i. Financing of an asset through hire purchase is very easy.

ii. Hire purchaser becomes the owner of the asset in future.

iii. Hire purchaser gets the benefit of depreciation on asset hired by him/her.

iv. Hire purchasers also enjoy the tax benefit on the interest payable by them.

Disadvantages of Hire Purchase:

Hire purchase financing suffers from following disadvantages:

i. Ownership of asset is transferred only after the payment of the last installment.

ii. The magnitude of funds involved in hire purchase are very small and only small types of assets like office equipment's, automobiles, etc., are purchased through it.

iii. The cost of financing through hire purchase is very high.

How are interest rate and hire purchase instalment calculated on a fixed rate hire purchase (HP) financing?

FIXED RATE FINANCING: Calculation of term charge and HP instalment

Term charge on a fixed rate HP financing is calculated on the **initial amount financed**. See example:

Amount financed	RM50,000
Term charges (Interest rate)	10% per annum
Tenure (Repayment period)	5 years (60 months)
Interest charged	(Amount financed) x (Rate) x (Years) = RM50,000 x 10% x 5 = RM25,000
Annual percentage rate	= 17.3%

The monthly instalment is calculated as follows:
Monthly Instalment

$$= \frac{\text{Amount financed + Total interest on amount financed}}{\text{Repayment period (months)}}$$

$$= \frac{\text{RM50,000 + RM25,000}}{60}$$

$$= \frac{\text{RM75,000}}{60}$$

= RM1,250

Since term charges are calculated on the initial amount financed, you will get a rebate on the term charges if you repay in full the balance due under the hire purchase (HP) agreement.

Using the earlier example, where your HP tenure is 5 years (60 months) and you would like to pay off your loan after paying 48 monthly instalments, you will get a rebate on the term charges for the remaining 12 months (i.e. 60 months - 48 months = 12 months). The calculation of rebate is as follows:

Total term charges on the amount financed is RM25,000.

Calculation of rebate on interest:

Rebate on interest

$$= \frac{\text{RM25,000x}(1+2+3+...n)}{(1+2+3+...k)}$$

where:

n = remaining repayment period (in months)

i.e. 12 months k = original repayment period (in months)

i.e. 60 months

Rebate on interest

$$= \frac{\text{RM25,000 x } (1+2+3+...+12)}{(1+2+3+...+60)}$$

$$= \frac{\text{RM25,000 x 78}}{1,830}$$

= RM1,066

Legal Position of Hire Purchase:

The Hire Purchase Act, 1972 defines a hire purchase agreement as an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:

(i) Possession of goods is delivered by the owner there off to a person on a condition that such person pays the agreed amount in periodic payments, and

(ii) The property in the goods is to pass to such person on the payment of the last of such installments, and

(iii) Such person has a right to terminate the agreement at any time before the property so passes." Section 3 of the Act provides that every hire purchase agreement must be in writing and signed by all parties thereto.

Rights of Hirer:

In addition to the usual right of terminating the agreement at any time before the property passes to him and returning the goods to the hiree, the Hire Purchase Act, 1972 has provided the following rights to the hirer:

(i) The hiree (vendor) cannot terminate the hire purchase agreement for default in payment of hire or due to an un-authorised act or breach of expressed conditions unless a notice in writing in this regard is given to the hirer. The period of notice will be one week where the hire is payable weekly or less than that interval and two weeks in other cases.

(ii) The right to repossess the goods will not exist unless sanctioned by the Court in the following cases:

(a) Where the hire purchases price is less than Rs. 15,000, one half of the hire purchase price has been paid

(b) Where the hire purchase is not less than Rs. 15,000, three fourth of hire-purchase price has been paid.

However this proportion in case of motor vehicles is as under:

(a) One half, where the hire purchase price is less than Rs. 5,000.

(b) Three fourths, where the hire purchase price is not less than Rs. 5,000 but less than Rs. 15,000.

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

(iii) The hirer has a right of receiving a statement from the owner against a payment of rupee one showing the amount paid by or on behalf of the hirer, the amount which has become due under the agreement but remains unpaid and the date upon which each unpaid installment became due, and the amount of each such installment and the amount which is to become payable under the agreement and the date or the mode of determining the date upon which each future installment is to become payable, and the amount of each such installment.

(iv) If the amount paid by the hirer till the date of repossession of the goods or the value of the goods on the date of repossession of goods exceeds the total hire purchase price the excess payment made by the hirer will be returned to the hirer by the owner of the goods.

The owner or vendor, for the purpose of calculating the value of the goods, has the right to deduct the reasonable expenses for repossessing the goods, for storing the goods, or repairing them, for selling them and for payment of arrears of taxes.

Method of Computing Installment under Hire Purchase:

Under Hire Purchase, interest is usually charged on a flat rate for the period of hire. We can calculate the amount of installment by adding the amount of principal (cost of the asset) and the total interest for the period, and further by dividing the total amount of payment to be made by the number of installments.

Say, an equipment costing Rs. 1,00,000 is sold on hire purchase on the terms that interest will be charged at 15% p.a. on flat rate basis and the payment is to be made in 5 equal year-end installments.

In the above example, the total Interest burden shall be Rs. 75,000 i.e. 1,00,000 × 15/100 × 5 and the yearly installment shall be 1,00,000 + 75,000/5 = Rs. 35,000

Method of Splitting H.P. Installment into Interest and Principal Repayments:

(a) First of all interest included in each installment is calculated on the basis that interest in each installment shall be in ratio of amounts outstanding. In case the installments are of equal amounts, we can apply the sum of digit method.

(b) We can determine the amount of principal repayment in the installment by deducting from it the amount of interest calculated in (a) above.

The following illustration explains the method of split of hire purchase installment into interest and principal repayments:

Illustration 1:

A company purchased an equipment costing Rs. 5,00,000 on hire purchase basis payable in 4 equal year end installments of Rs. 2,05,000 each. Split of the Installments into interest and principal repayments.

Solution:

In the above Illustration, the total amount payable is Rs. 8,20,000-5,00,000.

The interest can be allocated as below:

Instalment 1	$3,20,000 \times 4/10$	₹ 1,28,000
Instalment 2	$3,20,000 \times 3/10$	₹ 96,000
Instalment 3	$3,20,000 \times 2/10$	₹ 64,000
Instalment 4	$3,20,000 \times 1/10$	₹ 32,000

Split of H.P. Instalment can be computed as below :

Year	*H.P. Instalment* (₹)	*Interest* (₹)	*Repayment* (₹)
1	2,05,000	1,28,000	77,000
2	2,05,000	96,000	1,09,000
3	2,05,000	64,000	1,41,000
4	2,05,000	32,000	1,73,000

Leasing Versus Hire Purchase:

Both Leasing and hire purchase provide a source of financing fixed assets. However the two are not similar on many accounts.

The following points of distinction are worth consideration from points of view of the lessee and the hirer:

Point of Difference	Leasing	Hire Purchase
1. Ownership	Ownership is not transferred to the lessee.	Ownership is transferred to the hirer on payment of last instalment.
2. Tax Deductibility	Entire lease rentals are tax-deductible expenses.	Only the interest component and not the entire instalment is deductible.
3. Depreciation and Other Allowances	Cannot be claimed by the lessee	Can be claimed by the hirer.
4. Salvage Value	Lessee cannot realise salvage value of the asset on the expiry of the lease of life of the asset.	Hirer can realise the salvage value of the asset after payment of last instalment and expiry of the life of the asset.

Selecting between Leasing and Hire Purchase:

If a firm has the choice of selecting between leasing and hire purchase, it should evaluate the financial viability of both the proposals by adopting the normal methods of capital budgeting. We would prefer the technique of comparison of the present values of net outflows after-tax from the two options. The option with lower present value of cash outflows implies lesser cost and hence should be selected.

<u>Credit Rating – Meaning & Functions</u>

Credit Rating is an assessment of the borrower (be it an individual, group or company) that determines whether the borrower will be able to pay the loan back on time, as per the loan agreement. Needless to say, a good credit rating depicts a good history of paying loans on time in the past. This credit rating influences the bank's decision of approving your loan application at a considerate rate of interest.

It is usually expressed in alphabetical symbols. Although, it is a new concept in Indian financial market but slowly its popularity has increased. It helps investors to recognize the risk involved in lending the money and gives a fair assessment of the borrower's creditability.

<u>Importance of Credit Rating</u>

Here are the benefits of credit rating:

For The Money Lenders

1. **Better Investment Decision**: No bank or money lender companies would like to give money to a risky customer. With credit rating, they get an idea about the credit worthiness of an individual or company (who is borrowing the money) and the risk factor attached with them. By evaluating this, they can make a better investment decision.

2. **Safety Assured**: High credit rating means an assurance about the safety of the money and that it will be paid back with interest on time.

For Borrowers

1. **Easy Loan Approval**: With high credit rating, you will be seen as low/no risk customer. Therefore, banks will approve your loan application easily.

2. **Considerate Rate of Interest**: You must be aware of the fact every bank offers loan at a particular range of interest rates. One of the major factors that determine the rate of interest on the loan you take is your credit history. Higher the credit rating, lower will the rate of interest.

How do Credit Ratings Work in India?

As a matter of fact, every credit rating agency has their algorithm to evaluate the credit rating. However, the major factors are credit history, credit type and duration, credit utilization, credit exposure, etc. Every month, these credit rating agencies collect credit information from partner banks and other financial institutions. Once the request for credit rating has been made, these agencies dig out the information and prepare a report based on such factors. Based on that report, they grade every individual or company and give them a credit rating. This rating is used by banks, financial institutions and investors to make a decision of investing money, buying bonds or giving loan or credit card. The better is the rating, more are the chances of getting money at payable interest rates.

Credit Rating Agencies in India

Credit rating agency is an organization that evaluates the credit worthiness of an individual, business or company who wishes to borrow money or apply for a credit card in the bank. Let's have a look at the credit agencies in India.

CRISIL

Credit Rating Information Services of India Limited is the first credit rating agency of the country which was established in 1987. It calculates the credit worthiness of companies based on their strengths, market share, market reputation and board. It also rates companies, banks and organizations, helping investors make a better decision before investing in companies' bonds. It offers 8 types of credit rating which are as follows:

- AAA, AA, A – Good Credit Rating
- BBB, BB – Average Credit Rating
- B, C, D – Low Credit Rating

ICRA

Investment Information and Credit Rating Agency of India was formed in 1991 and is headquartered in Mumbai. It offers comprehensive ratings to corporates via a transparent rating system. Its rating system includes symbols which vary with the financial instruments. Here are the types of credit ratings offered by ICRA:

- Bank Loan Credit Rating
- Corporate Debt Rating
- Corporate Governance Rating
- Financial Sector Rating
- Issuer Rating
- Infrastructure Sector Rating
- Insurance Sector Rating
- Mutual Fund Rating
- Public Finance Rating
- Project Finance Rating
- Structured Finance Rating
- SME Rating

CARE

Credit Analysis and Research Limited (CARE) offers a range of credit rating services in areas like debt, bank loan, corporate governance, recovery, financial sector and more. Its rating scale includes two categories – long term debt instruments and short term debt ratings.

ONICRA

Onida Individual Credit Rating Agency of India established in 1993 which offers credit assessment and credit scoring services to both individuals and businesses. Along with this, it also offers risk assessment reports to individuals, small and medium businesses and corporates. Its ratings are based on two factors – Financial Strength and Performance Capability.

SMERA

Small Medium Enterprises Rating Agency Of India Limited has two divisions – SME Ratings and Bond Ratings. It was established in 2011 and is a hub of financial professionals. It offers credit ratings in the following format:

- AAA, AA, A – Low Credit Risk

- BBB, BB – Moderate Credit Risk
- B, C – High Credit Risk
- D- Defaulted

Brickwork Ratings India Private Limited

Headquartered in Bangalore, this credit rating agency is responsible to rate bank loans, municipal corporation, capital market instrument and SMEs. Other than this, it is also responsible to grade real estate investments, hospitals, NGOs, MFI, etc. It offers various rating system depending upon the different financial instrument.

Difference Between Credit Rating and Credit Score

Credit Rating is basically a credit worthiness of a business or a company. However, it is not really used to individuals like us. It gives an understanding the ability of the company. These ratings are based on corporate financial instruments and usually denoted in alphabetical symbols. Higher the rating, lower is the probability of default pays.

Whereas credit score is a number, calculated by credit bureau and given to individuals based on the credit information report. This number can be in between 300 and 900. Credit report plays an important role in loan and credit card approval process.

Legal framework

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

a. Possession of goods is delivered by the owner thereof to a person on the condition that such person pays the agreed amount in periodic payments

b. The property of the goods is to pass to such a person on the payment of the last of such instalment c. Such a person has a right to terminate the agreement any time before the property so passes‖.

All Hire purchase finance companies are controlled by the Hire Purchase Act, 1972. A Hire purchase transaction has two elements, Bailment which is governed by the Indian Contract Act, 1872 and Sale under the Sale of Goods Act, 1930.

Hire Purchase Agreement

a Hire Purchase Agreement is an agreement between the seller and the buyer, where the ownership of goods does not pass to the buyer until he pays the last instalment. There are two parties to the hire purchase agreement. The hire vendor, who is the seller and other, is the hire purchaser, the buyer. The purchaser has to make a down payment of 20 to 25% of the cost and the remaining amount has to be paid in equal monthly instalments. In the case of a Deposit linked plan, the hire purchaser has to invest a fixed amount as fixed deposits in the finance company which is returned together with interest after the payment of the last instalment.

Parties to the Hire Purchase Contract:

There are two parties in a hire purchase contract 1. The intending seller 2. The intending purchaser or the hirer. Tripartite agreement 1. Seller 2. Financier 3. Hirer/Purchaser

History behind Credit rating

Introduction with the increasing market orientation of the Indian economy, investors value a systematic assessment of two types of risks, namely "business risk" arising out of the "open economy" and linkages between money, capital and foreign exchange markets and "payments risk". With a view to protect small investors, who are the main target for unlisted corporate debt in the form of fixed deposits with companies, credit rating has been made mandatory. India was perhaps the first amongst developing countries to set up a credit rating agency in 1988.

The function of credit rating was institutionalised when RBI made it mandatory for the issue of Commercial Paper (CP) and subsequently by SEBI. when it made credit rating compulsory for certain categories of debentures and debt instruments. In June 1994, RBI made it mandatory for Non-Banking Financial Companies (NBFCs) to be rated. Credit rating is optional for Public Sector Undertakings (PSUs) bonds and privately placed non-conve11ible debentures up to Rs. 50 million. Fixed deposits of manufacturing companies also come under the purview of optional credit rating. Origin The first mercantile credit agency was set up in New York in 1841 to rate the ability of merchants to pay their financial obligations. Later on, it was taken over by Robert Dun. This agency published its first rating guide in 1859. The second agency was established by John Bradstreet in 1849 which was later merged with first agency to form Dun & Bradstreet in 1933, which became the owner of Moody's Investor's Service in 1962.

The history of Moody's can be traced back about a 100 years ago. In 1900, John Moody laid stone of Moody's Investors Service and published his 'Manual of Railroad Securities'. Early 1920's saw the expansion of credit rating industry when the Poor's Publishing Company published its first rating guide in 1916. Subsequently Fitch Publishing Company and Standard Statistics Company were set up in 1924 and 1922 respectively. Poor and Standard merged together in 1941 to form Standard and Poor's which was subsequently taken over by McGraw Hill in 1966. Between 1924 and 1970, no major new rating agencies were set up. But since 1970's, a number of credit rating agencies have been set up all over the world including countries like Malaysia, Thailand, Korea, Australia, Pakistan and Philippines etc. In India, CRISIL (Credit Rating and Information Services of India Ltd.) was setup in 1987 as the first rating agency

Meaning and Definition 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.

Importance of Credit Rating Credit ratings establish a link between risk and return. They thus provide a yardstick against which to measure the risk inherent in any instrument. An investor uses the ratings to assess the risk level and compares the offered rate of return with his expected rate of return (for the particular level of risk) to optimise his risk-return trade-off. The risk perception of a common investor, in the absence of a credit rating system, largely depends on his familiarity with the names of the promoters or the collaborators. It is not feasible for the corporate issuer of a debt instrument to offer every prospective investor the opportunity to undertake a detailed risk evaluation. It is very uncommon for different classes of investors to arrive at some uniform conclusion as to the relative quality of the instrument. Moreover, they do not possess the requisite skills of credit evaluation.

Nature of Credit Rating

1. Rating is based on information: Any rating based entirely on published information has serious limitations and the success of a rating agency will depend, to a great extent, on its ability to access privileged information. Cooperation from the issuers as well as their willingness to share even confidential information are important pre-requisites. The rating agency must keep information of confidential nature possessed during the rating process, a secret.

2. Many factors affect rating: Rating does not come out of a predetermined mathematical formula. Final rating is given taking into account the quality of management, corporate strategy, economic outlook and international environment. To ensure consistency and reliability a number of qualified professionals are involved in the rating process. The Rating Committee, which assigns the final rating, consists of specialised financial and credit analysts. Rating agencies also ensure that the rating process is free from any possible clash of interest.

3. Rating by more than one agency: In the well-developed capital markets, debt issues are, more often than not, rated by more than one agency. And it is only natural that ratings given by two or more agencies differ from each other e.g., a debt issue, may be rated 'AA+' by one agency and 'AA' or 'AA-' by another. It will indeed be unusual if one agency assigns a rating of AA while another gives a 'BBB'.

4.Monitoring the already rated issues: A rating is an opinion given on the basis of information available at particular point of time. Many factors may affect the debt servicing capabilities of the issuer. It is, therefore, essential that rating agencies monitor all outstanding debt issues rated by them as part of their investor service. The rating agencies should put issues under close credit watch and upgrade or downgrade the ratings as per the circumstances after intensive interaction with the issuers.

5.Publication of ratings: In India, ratings are undertaken only at the request of the issuers and only those ratings which are accepted by the issuers are published. Thus, once a rating is accepted it is published and subsequent changes emerging out of the monitoring by the agency will be published even if such changes are not found acceptable by the issuers.

6.Right of appeal against assigned rating: Where an issuer is not satisfied with the rating assigned, he may request for a review, furnishing additional information, if any, considered relevant. The rating agency will undertake a review and thereafter give its final decision. Unless the rating agency had over looked critical information at the first stage chances of the rating being changed on appeal are rare.

7.Rating of rating agencies: Informed public opinion will be the touchstone on which the rating companies have to be assessed and the success of a rating agency is measured by the quality of the services offered, consistency and integrity.

1. Rating is for instrument and not for the issuer company: The important thing to note is that rating is done always for a particular issue and not for a company or the Issuer. It is quite possible that two instruments issued by the same company carry different ratings, particularly if maturities are substantially different or one of the instruments is backed by additional credit reinforcements like guarantees. In many cases, short-term obligations, like commercial paper (CP) carry the highest rating even as the risk profile changes for longer maturities.
2. Rating not applicable to equity shares: By definition, credit rating is an opinion on the issuer's capacity to service debt. In the case of equity there is no pre-determined servicing obligation, as equity is in the nature of venture capital. So, credit rating does not apply to equity shares.

8.Credit vs. financial analysis: Credit rating is much broader concept than financial analysis. One important factor which needs consideration is that the rating is normally done at the request of and with the active co-operation Of the issuer. The rating agency has access to unpublished information and the discussions with the senior management of issuers give meaningful insights into corporate plans and strategies. Necessary adjustments are made to the published accounts for the purpose of analysis. Rating is carried out by specialised professionals who are highly qualified and experienced. The final rating is assigned keeping in view the number of factors.

9.Time taken in rating process: The rating process is a fairly detailed exercise. It involves, among other things analysis

10. Instruments for Rating may be carried out by the rating agencies in respect of the following: i. Equity shares issued by a company. ii. Preference shares issued by a company. iii. Bonds/debentures issued by corporate, government etc. iv. Commercial papers issued by manufacturing companies, finance companies, banks and financial institutions for raising short-term loans. v. Fixed deposits raised for medium-term ranking as unsecured borrowings. vi. Borrowers who have borrowed money. vii. Individuals. viii. Asset backed securities are assessed to determine the risk associated with them. The objective is to determine quantum of cash flows emerging from the asset that would be sufficient to meet committed payments.

Rating Other than Debt Instruments Credit Rating has been extended to all those activities where uncertainty and risk is involved. Now-a-days credit rating is not just limited to debts instruments but also covers the following:

I.Country Rating A country may be rated whenever a loan is to be extended or some major investment is to be made in it by international investors to determine the safety and security of their investments. A number of factors such as growth rate, industrial and agricultural production, government policies, inflation, fiscal deficit etc. are taken into consideration to arrive at such rating. Any upgrade movement in such—ratings has a positive impact on the stock markets. Morgan Stanley, Moody's etc. give country ratings.

II. Rating of Real Estate Builders and Developers CRISIL has started assigning rating to the builders and developers with the objective of helping and guiding prospective real estate buyers. CRISIL thoroughly scrutinises the sale deed papers, sanctioned plan, lawyers' report government clearance certificates before assigning rating to the builder or developer. Past experience of the builder, number of properties built by the builder, financial strength, time taken for completion are some of the factors taken into consideration by the CRISIL before giving a final rating to the real estate builder/ developer.

III. Chit Funds Chit funds registered as a company are sometimes rated on their ability to make timely payment of prize money to subscribers. The rating helps the chit funds in better marketing of their fund and in widening of the subscribers' base. This service is provided by CRISIL.

IV. Rating of States of India have also approached rating agencies for rating. Rating helps the State to attract investors both from India and abroad to make investments. Investors find safety of their funds while investing in a state with good rating. Foreign companies also come forward and set up projects in such states with positive rating. Rating agencies take into account various economic parameters such as industrial and agricultural growth of the State, availability of raw material, labor etc. and political parties agenda with respect to industry, labor etc., relation between Centre and State and freedom enjoyed by the states in taking decisions while assigning final rating to the states. States like Maharashtra, Madhya Pradesh, Tamil Nadu, Andhra Pradesh and Kerala have already been rated by CRISIL.

V. Rating of Banks CRISIL and ICRA both are engaged in rating of banks based on the following six parameters also called CAMELS. C - C stands for capital adequacy of banks. A bank need to maintain at least 10 % capital against risky assets of the bank. A - A stands for asset quality. The loan is examined to determine non-performing assets. An asset/loan is considered non-performing asset where either interest or principal is unpaid for two quarters or more. Ratios like NPA to Net

Advances, Adequacy of Provision & Debt Service Coverage Ratio are also calculated to know exact picture of quality of asset of a bank. M - M stands for management evaluation. Here, the efficiency and effectiveness of management in framing plans and policies is examined. Ratios like Return on Capital Employed (ROC E), Return on Assets (ROA) are calculated to comment upon bank's efficiency to utilise the assets. L - L indicates liquidity position. Liquid and current ratios are determined to find out banks' ability to meet its short-term claims. S - S stands for Systems and Control. Existing systems are studied in detail to determine their adequacy and efficacy. Thus, the above six parameters are analysed in detail by the rating agency and then final rating is given to a particular bank. Ratings vary from A to D. Where A denotes financial, managerial and operational soundness of a bank, and D denotes that bank is in financial crisis and lacks managerial expertise and is facing operational problems.

VI. Rating (Recommendation) for Equities These days' analysts specialised in equity ratings make a forecast of the stock prices of a company. They study thoroughly the trend of sales, operating profits and other variables and make a forecast of the earning capacity and profitability position of a company. They use financial statement analysis tools like ratio analysis, trend analysis, fund flow analysis and cash flow analysis to comment upon company's liquidity, solvency, profitability and overall efficiency position.

Analysts suggests a target price of the stock giving signal to the investor to swing into action whenever the stock hits that particular price. The following are some of the recommendations made by the equity analysts for its investors: i. Buy: It shows the stock is worth buying at its current price. ii. Buy on Declines: This recommendation indicates stock is basically good but overpriced now. The investor should go for buying whenever the price declines. iii. Long-term Buy: This recommendation suggests that a stock should be bought and held for a longer period at least a year in order to realise gains. iv. Strong Buy: This buy recommendation strongly favors the purchase of a stock because analysts expect a steep rise in the prices of stock from its current price. v. Out-performer: This recommendation shows that whatever may be the mood of the stock market the stock will perform better than the market. vi. Overweight: This refers to that investor can increase the quantum or weight of that stock in his portfolio. This recommendation is applicable to those investors who keep number of stocks in their portfolio. vii. Hold: This recommendation is a suggestion to the investor to exit because stock prices are not likely to be appreciated significantly from the current price level. viii. Sell/Dispose/Sub-Standard/Under-weight: It indicates to the investor to sell/dispose of or decrease the weight of stock from its portfolio because stock is fundamentally overvalued at its current level and the investor' should exit from it immediately.

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 authenticate 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 analyse the same. At last these interpret and summarise 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.

Advantages of Credit Rating

Different benefits accrue from use of rated instruments to different class of investors or the company. These are explained as under: A. Benefits to Investors

1. Safety of investments. Credit rating gives an idea in advance to the investors about the degree of financial strength of the issuer company. Based on rating he decides about the investment. Highly rated issues gives an assurance to the investors of safety of Investments and minimizes his risk.

2. Recognition of risk and returns. Credit rating symbols indicate both the returns expected and the risk attached to a particular issue. It becomes easier for the investor to understand the worth of the issuer company just by looking at the symbol because the issue is backed by the financial strength of the company.

3. Freedom of investment decisions. Investors need not seek advice from the stock brokers, merchant bankers or the portfolio managers before making investments. Investors today are free and independent to take investment decisions themselves. They base their decisions on rating symbols attached to a particular security. Each rating symbol assigned to a particular investment suggests the creditworthiness of the investment and indicates the degree of risk involved in it.

4. Wider choice of investments. As it is mandatory to rate debt obligations for every issuer company, at any particular time, wide range of credit rated instruments are available for making investment. Depending upon his own ability to bear risk, the investor can make choice of the securities in which investment is to be made.

5. Dependable credibility of issuer. Absence of any link between the ratter and rated firm ensures depend credibility of issuer and attracts investors. As rating agency has no vested interest in issue to be rated, and has no business connections or links with the Board of Directors. In other words, it operates independent of the issuer company, the rating given by it is always accepted by the investors.

6. Easy understanding of investment proposals. Investors require no analytical knowledge on their part about the issuer company. Depending upon rating symbols assigned by the rating agencies they can proceed with decisions to make investment in any particular rated security of a company.

7. Relief from botheration to know company. Credit agencies relieve investors from botheration of knowing the details of the company, its history, nature of business, financial position, liquidity and profitability position, composition of management staff and Board of Directors etc. Credit rating by professional and specialised analysts' reposes confidence in investors to rely upon the credit symbols for taking investment decisions.

8. Advantages of continuous monitoring. Credit rating agencies not only assign rating symbols but also continuously monitor them. The Rating agency downgrades or upgrades the rating symbols following the decline or improvement in the financial position respectively.

Disadvantages of Credit Rating

Credit rating suffers from the following limitations

1. Non-disclosure of significant information. Firm being rated may not provide significant or material information, which is likely to affect the investor's decision as to investment, to the investigation team of the credit rating company. Thus any decisions taken in the absence of such significant information may put investors at a loss.

2. Static study. Rating is a static study of present and past historic data of the company at one particular point of time. Number of factors including economic, political, environment, and government policies have direct bearing on the working of a company. Any changes after the assignment of rating symbols may defeat the very purpose of risk indicating of rating.

3. Rating is no certificate of soundness. Rating grades by the rating agencies are only an opinion about the capability of the company to meets its interest obligations. Rating symbols do not pinpoint towards quality of products or management or staff etc. In other words, rating does not give a certificate of the complete soundness of the company. Users should form an independent view of the rating symbol.

4. Rating may be biased. Personal bias of the investigating team might affect the quality of the rating. The companies having lower grade rating do not advertise or use the rating while raising funds from the public. In such a case the investors cannot get the true information about the risk involved in the instrument.

5. Rating under unfavourable conditions. Rating grades are not always representative of the true image of a company. A company might be given low grade because it was passing through unfavourable conditions

when rated. Thus, misleading conclusions may be drawn by the investors which hampers the company's interest.

6. Difference in rating grades. Same instrument may be rated differently by the two rating agencies because of the personal judgment of the investigating staff on qualitative aspects. This may further confuse the investors.

Credit Rating Meaning | Process | Agencies in India

Credit Rating Meaning | Process | Agencies in India. Credit Rating is the evaluation of the credit worthiness of an instrument of a company based on perceived overall risk of a company's business and financial profile as well as structural consideration. Credit rating establishes a link between risk and return. An investor or any other interested person uses the rating to assess the risk level and compares the offered rate of return with his expected rate of return. It facilitates the investors in taking a decision whether to go for an investment or not. The agency, which performs the credit rating is called the Credit Rating Agency.

Following Points May be Noted in Respect of Credit Rating

1. Credit rating is an assessment of a borrower's willingness and ability to repay the rated obligation in accordance with its terms and conditions.
2. It is only an opinion but not a recommendation to purchase, sell, or hold a borrower's security.
3. The agencies change ratings only for significant and permanent changes in a company's financial and operating performances
4. Credit rating agencies rate securities and not issuers. Generally, the rating of highest rated debt is taken as the rating of the company.

Credit Rating Agencies

The Credit Rating Agencies (CRA) is one of the capital market intermediaries. It is a body corporate, which is engaged in the business of rating of securities offered by way of public issue or right issue.

Rating means an opinion regarding securities, expressed in the form of standard symbols (numeric, alphanumeric and alphabets) or any other standardized manner assigned by a CRA and used by the issuer of such securities. For instance, public issues of convertible / redeemable debentures/bonds having a maturity period of more than 18 months requires credit rating. Similarly, issue of commercial paper in India also requires a specified credit rating.

Credit Rating Agencies in India

Following are the important CRA in India:

I. Credit Analysis and Research Limited (CARE)
II. Investment Information and Credit Rating Agency of India Limited (ICRA)
III. Credit Rating and Information Services (India) Limited (CRISIL)
IV. FITCH Credit Ratings India Private Limited
V. Standard and Poor's Corporation.

Registration of CRA

It may be noted that as per Section 12 of the SEBI Act, 1992, a person has to get itself registered with SEBI under SEBI (Credit Rating Agencies) Regulations, 1999 in order to carry on the activities of Credit Rating. Every CRA shall abide by the code of conduct contained in the Third Schedule to SEBI (Credit Rating Agencies) Regulations, 1999.

It may be noted that SEBI (Credit Rating Agencies) Regulations, 1999 cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates, etc.

Uses of Credit Rating

Credit rating is useful to the following:

Investors: In absence of credit rating, an investor has to make investment based on general available information about the company and its promoters and properly analysed opinions of a credit rating agency minimizes the risk.

Issuers: Market places faith in the opinion of credit rating agencies. This enables the issuers of high rated instruments to access the market even during adverse conditions.

Intermediaries: Credit Rating also helps intermediaries like merchant bankers, brokers, etc. Credit Rating helps merchant bankers in pricing of the issues whereas it helps the brokers in monitoring their risk exposure. **Regulators:** In India, the main regulator related to securities market is SEBI and one of the important functions of SEBI is to protect the interest of investors in securities market. SEBI ensures this by specifying requirement of a certain credit rating for a particular instrument.

Promoters of a CRA

A CRA can be promoted only by any of the following:

– A public financial institution;

– Scheduled commercial bank;

– A foreign bank;

– A foreign credit rating agency having minimum 5 years of experience;

– A body corporate having net worth of □100 crores in each of the immediately preceding 5 years.

Procedure For Credit Rating

Generally, CRA follows the following procedure/process for credit rating:

a. Seek information required for the rating from the company

b. On receipt of required information, have discussion with the company’s management and visit the company’s operating locations, if required.

c. Prepare an analytical assessment report.

d. Present the analysis to a committee comprising senior executives of the concerned CRA e.

The aforesaid committee would discuss all relevant issues and assign a rating

f. Communicate the rating to the company along with an assessment report outlining the rationale for the rating assigned.

THE GENERAL OBLIGATION OF PORTFOLIO MANAGERS AS ENUNCIATED BY THE SEBI

Following are the general obligations of portfolio managers as enunciated by the SEBI:

A. **Contract with Clients**

Every portfolio manager shall, before taking up an assignment of management of funds or portfolio of securities in writing on behalf of a client, enter into an agreement in writing with such client clearly defining the interrelationship, and setting out their mutual rights, liabilities and obligation relating to management of funds or portfolio of securities containing the details as specified in Schedule IV. The agreement between the portfolio manager and the client shall, inter alia, contain the following:

The funds of all clients shall be placed by the portfolio manager in a separate account to be maintained by him in a scheduled commercial bank (any bank included in the
Second Schedule to the Reserve bank of India Act, 1934 (2 f 1934)

Notwithstanding anything contained in the agreement between a portfolio manager and his client referred to in regulation 14 hereof, the portfolio funds can be withdrawn or taken back by Portfolio client at his risk before the maturity date of the contract the following circumstances:

1. Voluntary or compulsory, termination of Portfolio management services by the Portfolio manager;
2. Suspension or termination of registration of Portfolio manager by the Board;
3. Bankruptcy or liquidation in case the portfolio manager is a body corporate; and
4. Permanent disability, lunacy or insolvency in case the portfolio manager is an individual.

The portfolio manager shall not, while dealing with client's funds, indulge in speculative transactions, that is, he shall not enter into any transaction for purchase or sale of any security, which transaction is periodically or ultimately settled otherwise than by actual delivery or transfer of security.

In the event of any dispute between the portfolio manager and his clients, the client shall have the right to obtain details of his portfolio from the portfolio manager.

Contents

The contents of agreement between the Portfolio Manager and His clients are as follows:

1. **Appointment** of Portfolio manager.
2. **Scope of services** to be provided by the Portfolio Manager subject to the activities permitted under SEBI (Portfolio Managers) regulations, 1993, viz. advisory, investment management, custody of securities and keeping track of corporate benefits associated with the securities. The portfolio Manager shall act in a fiduciary capacity and as a trustee and agent of the client's account.
3. **Function, obligations, duties and responsibilities** (as discretionary and non-discretionary to be given separately) with specific provisions regarding instruction for nondiscretionary portfolio manager inter alia:

a) Terms in compliance with the Act, SEBI (Portfolio Managers) Regulations, 1993, rules, regulations guidelines made under the Act and any other laws/rules/regulations/guidelines etc.
b) Providing reports to clients.
c) Maintenance of client-wide transactions and related books of accounts.
d) Provisions regarding audit of accounts as required under the SEBI (Portfolio Manager Regulations, 1993).
e) Settlement of accounts and procedure therefore, including the provisions for payment of maturity or early termination of contract.

4. **Investment objectives and guidelines such as following:**

a. Types of securities in which investment would be made specifying restrictions, if any.
b. Particulars regarding amount, period of management, repayment or withdrawal
c. Taxation aspects such as Tax Deducted at Source, etc. if any.
d. Condition that the portfolio manager shall not lend the securities of the client unless authorized by him in writing.

5. **Risk factors:** A detailed statement of risks associated with each type of investment including the standard risks associated with each type of investment risk factors specific to the scheme as well as the attendant to specific investment policies and objectives of the scheme are to be mentioned.
6. **Period of agreement:** Minimum period of any, and provision for renewal, if any.
7. **Conditions** under which agreement may be altered, terminated and implications thereof, such as settlement of amounts invested, repayment obligations, etc.

8. **Maintenance of Accounts:** Maintenance of accounts separately in the name of the client as are necessary of account for the assets and any additions, income, receipts and disbursements in connection therewith, as provided under SEBI (Portfolio Managers) regulations, 1993.

   Terms of Fees: The quantum and manner of payment of fees and charges for each activity for which services are rendered by the Portfolio Manager directly or indirectly (where such service is outsourced) such as invest management, advisory, transfer, registration and transaction costs with specific references to brokerage costs, custody charges, cost related to furnishing regular communication, accountant statement, miscellaneous expenses (individual expenses in excess of 5 percent to be indicated separately). Etc.
10. **Billing:** Periodicity of billing, whether payment to be made in advance, manner of payment of fees, whether setting off against the account, etc. type of documents evidencing receipt of payment of fees.
11. **Liability of Portfolio Manager:** Liability of Portfolio Manager in connection with recommendations made, to cover errors of judgment, negligence, willful misfeasance in connection with discharge of duties, acts of other intermediaries, brokers, custodian, etc.
12. **Liability of client** restricting the liability of the client to the extent of his investment.
13. **Death or disability:** Providing for continuation/termination of the agreement in the event of client's death/disability, succession, nomination, representation, etc. to be incorporated.
14. **Assignment** conditions for assignment of the agreement by client.
15. **Governing Law:** The law/jurisdiction of country/State which governs the agreement are to be stated.
16. **Settlement of grievances/disputes and provision for arbitration:**
   Provisions to cover protection of act done in good faith, risks and losses, redress of grievances, dispute resolution mechanism reference for arbitration and the situations under which such rights may arise, may be made.

B. Disclosures

The Portfolio Manager shall provide to the client the Disclosure Document as specified in Schedule V, along with a certificate in Form C as specified in Schedule I, at least two days prior to entering into an agreement with the client as referred to in sub-regulation (1). The disclosure document shall inter alia contain the following:

1. The quantum and manner of payment of fees payable by y the client for each activity for which service is rendered by the Portfolio Manager in Schedule I, at least two days prior to entering into an

agreement with the client as referred to in sub-regulation (1). The Disclosure Document shall inter alia contain the following:

2. Portfolio risks;
3. Complete disclosures in respect of transactions with related parties as per the accounting standards specified by the institute of chartered accountants of India in this regard.
4. The performance of the Portfolio Manager; and
5. The audited financial statements of the Portfolio Manager for the immediately preceding three years.

The Portfolio Manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both.

The Portfolio Manager may, subject to the disclosure in terms of the disclosure Document and specific permission from the client, charge such fees from the client for each activity for which service is rendered by the Portfolio Manager directly or indirectly (where such service is out sourced).

DEPOSITORY RECEIPTS

Introduction

A receipt issued by a 'Depository' of a country against the deposit of shares issued by a domestic company which is eligible for issue of foreign investors and is eligible for trading on an overseas stock exchange, is known as a 'Depository Receipt' (DR), issue of a depository receipt connotes issue of ordinary share to global investor, by keeping the share sunder the custody of a 'Domestic custodian Bank'.

A 'Depository Receipt' is a type of negotiable (transferable) financial security that is traded on a local stock exchange but represents a security, usually in the form of equity that is issued by a foreign publicity listed company. The DR, which is a physical certificate, allows investors to hold share is equity of other countries.

Depository receipts make it easier to buy shares in foreign companies because the shares of the company don't have to leave the home State. When the depository bank is in the USA, the instruments are known as American Depository receipt (ADR). European banks issue European Depository receipts, and other banks issue Global Depository receipt (GDR).

ADRs are typically traded on a U.S national stock exchange, such as the New York Stock Exchange (NYSE) or the American Stock Exchange (AMEX), while GDRs are commonly listed on European stock exchanges such as the London Stock Exchange (LSE). Both ADRs and GDRs are usually denominated in U.S. dollars, but can also be denominated in Euros.

Working Mechanism

ADR is created when a foreign company wishes to list its already publicly traded shares or debt securities or a foreign stock exchange. Initial Public Offerings (IPOs), however, can also issue a DR as well, DRs can be traded publicly over the counter. Let us look at an example of how an ADR is created and traded.

Based on a determined ADR ratio, each ADR may be issued as representing one or more of the Indian local shares, and the price of each ADR would be issued in U.S. dollars converted from the equivalent Indian price of the shares being held by the depository bank. The ADRs now represent the local Indian shares held by the depository, and can now be freely traded equity on the NYSE. After the process, whereby the new ADR of the Indian company is issued, the ADR can be traded freely among investors and transferred from the buyer to the seller on the NYSE, through a procedure known as intra market trading. The rights of the ADR holder are stated on the ADR certificate.

Pricing and Cross-trading

When any DR is traded, the broker will aim to find the best price of the share in question. Investor will therefore compare the U.S. dollar price of the ADR with the U.S. dollar equivalent price of the local share on the domestic market. If the ADR of the Indian company is trading at USD 42 per share and the share trading on the Indian market is trading at USD 41 per share (converted from rupees to dollars), a broker would aim to buy more local shares from India and issue ADRs on the U.S. market.

A U.S. broker may also sell ADRs back into the local Indian market. This is known as “cross – border trading.” When this happens, an amount of ADRs is cancelled by the depository and the local shares are released from the custodian bank and delivered back to the Indian broker who bought them.

Benefits of Depository Receipts

The DR functions as a means to increase global trade, which in trade can help to increase not only volumes on local and foreign markets but also the exchange of information, technology, regulatory procedures, and market transparency. Thus, instead of being faced with impediments of foreign investment, as it often the case in many emerging markets, the DR investor as well as the company can be benefited from investment abroad. Let’s take a closer a look at the benefits:

For the company A company may opt to issue a DR to obtain greater exposure and raise capital in the world market. Issuing DRs has the added benefit of increasing the share’s liquidity while boosting the company’s prestige on its local market. Moreover, in many countries, especially those with emerging markets, obstacles often prevent foreign investors from entering the local market. By issuing a DR, a company can still encounter investment from abroad without having to worry about barriers that a foreign investor might face.

For the investor buying into a DR immediately turns an investor's portfolio into a global one. Investor's gain the benefits of diversification, while trading in their own market under familiar settlement and clearance conditions. More importantly, DR investors will be able to reap the benefits of these usually higher-risk, higher-return, without having to endure the added risks of going directly into foreign markets, which may pose considerable difficulties in the form of lack of transparency or instability resulting from changing regulatory procedures.

THE CREDIT SYNDICATION SERVICES

Credit Syndication Services

Merchant bankers provide various services towards syndication of loans. The services vary depending on whether loans sought or of long-term fixed capital or of working capital funds. Following are the credit syndication services rendered by merchant bankers with regard to long-term loans:

1. Ascertaining promoter details
2. Ascertaining of cost details
3. Comparison of cost details
4. Identification of funding sources
5. Ascertainment of loan details
6. Furnishing beneficiary details
7. Making application
8. Project appraisal
9. Compliance for loan disbursement
10. Documentation and creation of security
11. Pre-disbursement compliance

Ascertaining of Promoter Details

This is the fundamental credit syndication service extended by merchant bankers, whereby attempts are made to gain an understanding about the promoters, who are involved in the launch and running of the project. Information is collected about the promoters, their knowledge, reputation, creditworthiness, experience in trade or industry and relevance of such skills and competence, etc. For this purpose, the merchant banker holds discussions with promoters. Information is also gleaned to know the extent of contribution made by promotes to fund the project. The contributions may include the quantum of preliminary expenses already incurred by them. E.

Ascertainment of Project Cost Details

Here, the merchant banker investigates about the project for which finance is to be arranged. Details about the project are collected with the help of information given by the consultant in the project report.

Merchant banks make an estimate of the capital cost of the project. This involves ascertaining the cost details of different items of expenditure. Some of the important items of costs that need to be ascertained by merchant banker are preliminary expenses connected with cost of promotion, incorporation, legal expenses etc., as applicable to setting up of new units.

Comparison of cost Details

Here, the merchant banker investigates about the project for which finance is to be arranged. Details about the project are collected with the help of information given by the consultant in the project report.

Merchant banks make an estimate of the capital cost of the project. This involves ascertaining the cost details of different items of expenditure. Some of the important items of costs that need to be ascertained by merchant banker are preliminary expenses connected with cost of promotion, incorporation, legal expenses etc., as applicable to setting up new units. Cost details pertaining to expansion, renovation, modernization of diversification programmes of existing units include cost of fixed assets that include cost of acquisition of land, construction of building, roads, railway siding, procurement of plant and equipment, furniture and fixtures of other miscellaneous fixed assets.

Comparison of cost Details

Another important function undertaken by merchant bankers is the comparison of the details of costs with the benchmarks available in the same industry. Other aspects such as the geographical area, size of scale of operations, etc. are also used for comparison. Adjustments are also made for inflationary conditions which help capturing rising prices of different elements of cost.

Identification of Funding Sources

Identifying appropriate sources of capital required for financing the project is another function of a merchant banker in his credit syndication services. Many factors determine the choice of capital funding source. Most important among them are the nature of the project, and the quantum of the project cost. Nature of a project helps determine the quantum of project cost. For instance, scale of cost involved in a project would vary depending on whether the project is a small or medium or a large-sized project.

The sources of capital required for a project would be short-term, medium term, or long-term. A brief description of each source of fund is attempted below:

Short term source: Short-term funding source refers to funds required for a period up to one year short-term funds are required for meeting the working capital requirements or special seasonal needs of an industrial unit the popular sources of short-term funds are commercial banks, trade credit, public deposits, finance companies and also customers.

Medium-term source: Medium-term funding source refers to funds required for a period ranging from one to five years. Medium-term funds are needed for permanent working capital, expansion or replacement assets, or acquisition of balancing equipment's. Such funding is made available by banks and financial institutions loans. Medium-term loans are provided under the auspices of various lending schemes designed and operated by the all-India financial institutions.

Long-term source: Long-term funding source refers to funds required for a period of more than five years long-term funding is needed for undertaking the establishment of new units, for permanent investment, fixed assets, modernization, major expansion, diversification or rehabilitation of the existing projects. The chief source of long-term capital funds are debt funds and equity funds.

In addition to domestic sources available such as IDBI, ICICI, LIC, UTI, IRBI, SFCs, SIDCs etc., for securing long-term debt funds, international capital market sources are also tapped for raising debt fund.

Ascertainment of Loan Details

Merchant bankers ascertain details of criteria followed by the term-lending institutions to entertain projects for granting assistance. The objective is to pave way for the expeditious and favourable considerations of the loan application by the development finance institutions. For this purpose, merchant bankers hold preliminary discussions with the executives of the lending institutions. The preliminary discussions help the merchant banker clear the clouds as regards various aspects of seeking syndicated loan arrangements with the financial institutions.

The merchant banker also discusses matters connected with process of production, technical arrangements, plant capacity, professional skill required, procurement of license/DGTD registration, import license in case of any import of capital goods/raw material is involved, foreign collaboration, etc. Consultations are also held with the officials of the development finance institutions on the status of Foreign Exchange Management Act compliance.

Furnishing Beneficiary Details

An important function of credit syndication is furnishing of information relating to the borrower-beneficiary to the financial institution. The information is to be furnished in the application to be submitted by the merchant banker to the lending agency as part of the credit syndication arrangements. Following details are furnished by the merchant banker in this regard.

1. **General Information:** The purpose of furnishing general information is to enable the financing company to obtain a general idea about the applicant company and its proposed project. The information to be furnished by the merchant banker in this regard is stated below:

a. Name of constitution, date of incorporation and commencement of business.
b. Nature of organization, viz, public/private/joint/cooperative sectors
c. Name of the business house/group to which it belongs.
d. Location of registered office/head office
e. Nature of concessions to which the project seeking financial assistance is eligible.
f. Nature of industry and product
g. Installed capacity, both existing and proposed
h. Nature of currency loans applied for (whether rupee loans or foreign currency loans)
i. License issued by the government for undertaking production.
j. Financial assistance applied for by way of underwriting for equity capital/preference capital/ debenture.

2. **Promoter Information:** Information about promoters is furnished by the merchant banker with the objective of helping the lending agency to gain an understanding of the promoter, his activities, economic background, credibility and integrity.

a. Brief account of activities and past performance/other expansion programmes
b. Certified copies of Memorandum of Association. Articles of Association, audited balance Sheet and Profit and Loss Account for last five years

3. **Company Information:** The merchant banker has to furnish the following information as regards the company for loan syndication arrangements to be made:

a. Brief history of the concern.
b. Schemes already executed in the case of existing company

c. Expansion/diversification plans in the case of an existing company
d. Nature, size and status of the project to assess the funds requirement in the case of a new company
e. List of subsidiaries (with percentage of holding s and nature of business)
f. Directors of the company, their names, age, address, qualifications, past experience, business or industrial background, existing proposed shareholding in the company.
h. Certified copies of audited balance sheet and profit and loss account for the last five years with pro forma balance sheet and profit and loss account of a recent date Tax status of the company
i. Export of product (destination, export sales for past five years with export incentives available)
j. Insurance of fixed/other assets and risk covered and details of research and development activities of the company.

4. **Project profile information:** Full information relating to the project for which financial assistance is sought is furnished by the merchant banker. The type of information may pertain to plant capacity, nature of production process to be employed, nature of technical arrangements available for the project, and other information as specified below:
   a. Plant capacity information about the product-wise installed capacity/proposed capacity/ maximum production envisaged, section wise capacities for major sections of the plant.
   b. Plant process: Information about the technical process to be employed by the plant with a flow chart depicting material process and results.
   c. Plant technical arrangements: Details of technical arrangements made/proposed for implementation of the project, details of collaboration, if any, with write-up on their activities, size, turnover, particulars of existing plant, other projects in India and abroad along with copies of broachers as published by them for the last 3 years/ collaboration agreement/Government approval for collaborators/foreign technicians to be employed; name of consultants manner of payment, brief particulars of consultants (bio-data of senior personnel, names of directors), partners, particular of work done in the past and work on hand with copies of published material of consultant/ agreements with them and Government approval for foreign consultants.
   d. Plant management: Details of arrangements for executive management, particulars of proposed key technical / administrative and accounting personnel (with proposed organization chart indicating lines of authority).
   e. Plant assets: Details about various assets used by the borrowing firm are to be furnished by the merchant banker. The details as regards land and building include location of plant/requirement of land, Locational advantages of the land, details of the land area and cost, basis of valuation, mode of payment, date of purchase, lease, previous owner and relationship with promoters/

directors, conversion of land to industrial use, along with copies of sale/lease deeds/ soil test reports/Government order converting land into industrial use/location map/site plan showing contour lines/internal roads/ power receiving station/railway siding/tube wells, arrangements made proposed for constructions of buildings, etc.

f. **Plant transport:** Arrangements proposed for carrying raw materials/ finished goods by own trucks/railway siding, etc. private trucks should be furnished by the merchant banker.

5. **Other details:** In addition to the above, the merchant banker has to furnish information pertaining to the type and the nature of raw materials used and the source of availability, whether domestic or foreign. Details as to be demand, availability, tariff, cost, and the supply sources of utilities such as water, power, steam, compressed air, etc. should be furnished **Project cost information:** Details of the estimated cost of the project should be provided to the lending institution. This includes information as regards rupee cost/ rupee equivalent of foreign exchange cost/total cost for land or site development/ buildings/ plant and machinery, imported/indigenous, technical know-how etc. to be furnished.
6. **Project marketing information:** As part of the credit syndication exercise, it is incumbent on the part of the merchant banker to furnish adequate information about the marketing arrangements made for the products of the borrowing unit. Following are the information to be provided to the fund supplier in this regard.

a. Brief profile of the products beings offered
b. Scope of market for the products
c. Price aspects of the product
d. Estimates of existing and future demands and supply of proposed product
e. Special and the outstanding feature of the product that would give the firm a competitive advantage.
f. International CIF, FOB prices and landed cost of the propose product
g. List of principal customers and particulars of firms with whom such sale arrangements have been made
h. Details of restrictions imposed by the Government as regards price, distribution, export, etc.

7. **Cash Flow information:** The merchant banker has to furnish details as to profitability and expected stream of cash flows and cost of the propose project. For this purpose, it is essential that working results of operations, cash flow statements and project balance sheet are given in prescribed form along with the basis of the calculations.

8. Other information: The merchant banker has to indicate as to how the purpose of the economic and national importance of the proposed project will be realized. Besides, following are the other details to be furnished by the merchant banker to the lending agency:

a. CIF/FOB international price of inputs to be imported/exported
b. Excise duty, export duty, export assistance (replenishment license, duty drawback, cash subsidy, etc.)
c. Expected contribution to the growth, if any of ancillary industries in the region.
d. Government consent by way issue of letter of intent, industrial license, foreign exchange permission, approval of technical financial collaboration, etc.

In addition to the above, merchant banker has to furnish a declaration stating that all the necessary details have been furnished and that all the information so provided are correct.

ELECTRONIC SETTLEMENT OF TRADE PROCEDURE

I. **For Selling Dematerialized Securities**

The procedure for selling dematerialized securities in stock exchanges is similar to the procedure for selling physical securities. Instead of delivering physical securities to the broker, the investor must instruct his/her DP to debit his/her demat account with the number of securities sold by him/her and credit broker's clearing account. Procedure for selling securities is as follows:

1. Investor sells securities in any of the stock exchanges linked to Depository through a broker.
2. Investor gives instruction to DP to debit his account and credit the broker's (Clearing member proof) account.
3. Before the pay-in-day, investor's broker transfers the securities to clearing corporation.
4. The broker receives payment from the stock exchange (clearing corporation).
5. The investor receives payment from the broker for the sale in the same manner as that is received for a sale in the physical mode.

II. **For Buying Dematerialized Securities**

The procedure for buying dematerialized securities from stock exchanges in similar to the procedure for buying physical securities. Investor may give a one-time standing instruction to receive credits in his/her account or may give separate instruction each time in the prescribed format.

The transactions relating to purchase of securities are as follows:

1. Investor purchase securities in any of the stock exchanges connected to Depository through a broker.
2. Broker receives payment from investors
3. Broker arranges payment to the clearing corporation
4. Broker receives credit of securities in clearing account and credit client's account.
5. Investor receives shares in his account.

Demat of Debt Instruments

Debts instruments can also be held in demat form. Instruments like Bonds, Debentures, commercial Paper, Certificate of Deposit, etc. irrespective whether these instruments are listed/ unlisted/ privately placed or even issued to a single holder can be dematerialized. Commercial paper can also be kept in demat form. As per RBI Monetary and Credit Policy 2001-2002, Banking and Financial Institutions, Primary Dealers and Satellite Dealers are directed to convert their outstanding investment in commercial paper in scrip form, into demat for latest by October, 2001. The above entities have also been directed make fresh investment in commercial paper only in demats form June 30, 2001.

Allocation

Any new instrument can be issued directly in dematerialized form without resources to printing of either Letter of Allotment or Certificates. Securities will be directly credited into the demat account of the investor by the depositories on receipt of allotment details from RTA/company. The investor need not open separate demat account for demat of debt instruments.

Dematerialization

The procedure for dematerialization of debt instrument is the same as applicable for equity shares. In order to dematerialize his/her certificates; an investor will have to first open a debt account with a DP and then request for the dematerialization certificates by filling up a Dematerialization Request Form (DRF) which is available with DP and submitting the same along with the physical certificates. The investor has to ensure that the certificates handed over to the DP for demat, are marked "surrendered for dematerialization" on the face of the certificates.

Statement of holdings

A regular single statement of holding will reflect all the holdings in a particular demat account, irrespective of type of instrument.

Safety system for Demat

Demat services in order to be carried out effectively requires the following safety system to be put in place:

1. Strict norms for becoming a depository participant (DP), net worth criteria. SEBI approval, etc. are mandatory.
2. DP cannot effect any debit or credit in the demat account of the investor without the valid authorization of the investor.
3. Regular reconciliation between DP and Depositories
4. Periodic inspection of Depositories of the office of DP and Registrar (RTA)
5. All investors have a right to receive their statement of accounts periodically from the DP.
6. In the depository system, the depository holds the investor accounts on trust. Therefore, if the DP goes bankrupt the creditors of the DP will have no access to the holdings in the name of the clients of the DP. These investors can transfer their holdings to an account held with another DP.
7. Compulsory internal audit of operations of DP every quarter by practicing company secretary or chartered accountant.

POSSIBLE QUESTIONS
PART-A
Multiple Choice Questions
Online Quiz

PART-B

1.Write a note on consumer credit.

2. What are the Characteristics of Consumer Credit?

3. Define hire purchase and discuss its features.

4. What are the concepts of Hire Purchase?

5. Explain how the ratings assigned by the credit rating agency

PART-C

1. Explain the various rights of Hirer.
2. Discuss various methods of calculating interest in Hire Purchase.
3. Enumerate the rating for short term Debt under CRISIL

4. Narrate the rating for Debenture under CRISIL
5. Discuss in detail the role of banks in Hire Purchase?
6. Narrate the importance of Credit Rating Agencies operating in India.
7. Discuss the problems in Credit Rating the Instruments
8. Describe any three major international rating agencies operating in the present Financial Scenario?
9. Enumerate the various features of Hire Purchase Agreement
10. Narrate the difference between Hire Purchase, Instalment and Leasing.

PART –D

Planning for your Golden Years

Mr. Trivedi a 50 year old married individual wanted to retire at the age of 60 years. His spouse was the only member of his family dependent on him. He was earning Rs 87,000 per month, while his expenses were Rs 62,000 per month. So his monthly surplus was Rs 25,000 per month. Mr. Trivedi had a family history of living over 80 years so they were assumed to have life expectancy of 86 years.

Mr. Trivedi had more than 70% of his total investment portfolio in illiquid assets such as Residential Flat and Land. Mr. Trivedi had taken a home loan (EMI = Rs 20,000) for the construction of residential flat in which he and his family was staying. 10% of his investment portfolio was invested in Equity via Equity Mutual Funds and Equity Shares. He had opened a PPF account when he was 30 years old and extended it for 1 more block of 5 years, and now the PPF account will mature in next 2 months. He had also invested in Gold via Gold Mutual Funds. The Cash in Bank was mainly kept for contingencypurpose.He was nearing retirement and he thought that his assets were not sufficient to fund all his expenses during his golden years i.e. post retirementperiod. Mr. Trivedi had current total expenses of Rs 62,000 per month and wanted to maintain the same lifestyle during post retirement period as well. As he would have paid off his existing home loan by the time he retires, so his net total expenses required in current terms during the post retirement period is Rs 42,000 per month. Assuming inflation of 7% and post retirement return of 8% he required a retirement corpus of Rs227lakh.

Analyse and calculate retirement corpus.

Reg.No……………………

(17MBAPF303C)

Karpagam Academy of Higher Education
(Deemed to be University)
(Established Under section 3 of UGC Act 1956)
FIRST INTERNAL EXAMINATION – AUGUST 2018
II MBA – I SEMESTER
FINANCIAL SERVICES MANAGEMENT

Time: 2hours **Maximum: 50marks**

PART – A (15 X 1 = 15 Marks)
ANSWER ALL THE QUESTIONS

1. A merchant bank is a financial institution which shall not conducting money market activities and
A. Lending B. Underwriting and financial advice
C. Investment service D. Hedging

2. In India Merchant banking along with management of public issues and loan syndication covering activities like-
A. Project counselling B. Portfolio management
C. Investment counselling D. Mergers and amalgamation

3. Merchant Bankers who are bankers within the meaning of
A. Ministry of Finance B. Government of India
C. SEBI D. Banking Regulation Act

4._____ can be for both equity & debt.
A. Credit Rating B. Financial Service
C. Financial Sector D. Both (a) & (b)

5. Appointment of Intermediaries of MB shall not include
A. Appointment of MB B. Appointment of Co-Managers
C. Appointment of other Intermediaries D. Brokers

6. In India, the UTI setup the first _____ in 1964.
A. Credit Rating B. Mutual Fund
C. Factoring D. Leasing

7. ______ is regarded as the fourth element of the financial system.
A. Financial services B. Financial markets
C. Financial instruments D. Financial institutions

8. A Merchant Bank is also known as _____.
A. World Bank B. Commercial Bank
C. Wholesale Bank D. Special Bank

9. In India, merchant-banking activity was originated with the merchant banking division set up by the __________.
A. Barclays Bank B. Grind Lays Bank
C. Yes Bank D. No Bank

10._____ has made the quality of man-power as one of the criteria for registration as Merchant Bankers.
A. SEBI B. Pre-liberalization
C. Post-liberalization D. Issue Management

11. Business of Merchant Banking started in India since
A. 1967 B. 1969
C. 1956 D. 1986

12. Issue management is an important function of ______ and ______.
A. Public, Merchant banker B. Lead banker, Private banking
C. SEBI D. Merchant banker, lead manager

13._____ that is financial in nature are known as financial services.
A. Services B. Goods
C. Capital D. Structure

14. Code of Conduct of a Merchant Bankers shall not include
A. Fair Practice B. Best advice
C. Secrecy D. Qualification

15. Mandatory Collection centres shall include

A. Mumbai B. Hyderabad

C. Ahmadabad D. Haryana

PART – B (3 X 8= 24 Marks)

ANSWER ALL THE QUESTIONS

16. a) Discuss the Nature and Scope of Merchant Bankers.

(OR)

b) Evaluate the Pre and Post issue decision making by a Merchant Banker

17. a) Elucidate the important steps taken by SEBI for Regulating Mutual Funds in India

(OR)

b)What are the different methods of marketing securities?

18. a) Narrate the problems of Merchant Bankers.

(OR)

b) Enumerate the various qualities required for a Merchant Banker?

PART – C (1 X 11= 11 Marks)

19. Case Study (Compulsory):

No business could survive on its own without friends and allies. To be successful, businesses need to develop relationships with other organisations and to draw on the support and services they provide. The successful business will develop healthy relationships with suppliers, partners and providers of finance.In this case study, we look at a very important relationship for an increasing number of small and medium sized businesses in this country - the one that they build up with investors. In particular, we focus on the role of 3i Group, the leading specialist investor in unquoted companies in the UK. The role of investors is of crucial importance to the UK economy. In the past, countries like Japan and the United States led the field in providing support for the growth and development of the small and medium sized business sector. Today, the UK is rapidly catching up in this sphere. By the end of the 1980s, for example, there were over 100 member companies making up the British Venture Capital Association.

Comment on this case.

KARPAGAM UNIVERSITY
KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed University, Established Under Section 3 of UGC Act, 1956)
II MBA – Continuous Internal Assessment – I – AUGUST 2018
FINANCIAL SERVICES MANAGEMENT

ANSWER KEY

PART –A

1) d. Hedging
2) a. Project counselling
3) d. Banking Regulation Act.
4) a. Credit Rating
5) d. Brokers
6) d. Leasing
7) a. Financial services
8) c. Wholesale Bank
9) b. Grind Lays Bank
10) c. Post-liberalization
11) a.1967
12) d. Merchant banker, lead manager
13) b. goods
14) d. Qualification'
15) a.Mumbai

PART –B

16. a) Discuss the Nature and Scope of Merchant Bankers.

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. The Concept of the Merchant Banking study: Definition of Merchant Banking, Nature of Merchant Banking, Functions of Merchant Banking and Characteristics of Merchant Banking!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 the restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.

Merchant banking can be defined as a skill-oriented professional service provided by merchant banks to their clients, concerning their financial needs, for adequate consideration, in the form of fee.:

The Notification of the Ministry of Finance defines merchant banker as;

"Any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager-consultant, adviser or rendering corporate advisory services in relation to such issue management"

The Amendment Regulation specifies that issue management consists of a prospectus and other information relating to the issue, determining the financial structure, tie-up of financiers and final allotment and refund of the subscriptions, underwriting and portfolio management services.

In the words of Skully "A Merchant Bank could be best defined as a financial institution conducting money market activities and lending, underwriting and financial advice, and investment services whose organization is characterized by a high proportion of professional staff able to able to approach problems in an innovative manner and to make and implement decisions rapidly."Nature of Merchant Banking:

Merchant banking is skill-based activities and involves serving every financial need of every client. It requires focused skill-base to provide for the requirements of the client. SEBI has made the quality of manpower as one of the criteria for registration as the merchant banker. These skills should not be concentrated in issue management and underwriting alone, which may have an adverse impact on business. Merchant bankers can turn to any of the activities mentioned above depending upon resources, such as capital, foreign tie-ups for overseas activities and skills. The depth and sophistication in merchant banking business are improving since the avenues for participating in capital market activities have widened from issue management and underwriting to private placement, bought out deals (BODS), buy-back of shares, mergers, and takeovers.

The services of merchant bank cover project counseling, pre-investment activities, feasibility studies, project reports, the design of the capital structure, issue management, underwriting, loan syndication, mobilization of funds from Non-Resident Indians, foreign currency finance, mergers, amalgamation, takeover, venture capital, buyback and public deposits. A Category-1 merchant banker can undertake issue management only. Separate registration is not necessary to carry on the act as the underwriter

b) Evaluate the Pre and Post issue decision making by a Merchant Banker

Pre-Issue Activities

1) Memorandum of Understanding In terms of Regulation 18(2), before taking any issue management, every merchant banker (lead manager) must invariably enter into a Memorandum of Understanding (MoU) with the company making the issue (issuer) clearly setting out their mutual rights, liabilities and obligations relating to the issue. A draft of the MoU is prescribed. The lead manager may adopt the draft and incorporate such clauses as may be considered necessary for defining his rights and obligations vis-à-vis the issuer.

2) Obtaining Appraisal Note After the contract for issue management is awarded, an appraisal note is prepared either in-house or is obtained from outside appraising agencies viz., Financial Institutions/ Banks etc. The appraisal note thus prepared throws light on the proposed capital outlay on the project and the sources of funding it. Project may be funded either by borrowing money from outside agencies or by injecting capital. Optimum Capital Structure is determined considering the nature and size of the project. If the project is capital intensive, funding is generally biased in favour of equity funding.

3) Appointment of Other Intermediaries Lead manager should ensure that the requisite intermediaries, who are appointed, are registered with SEBI. Before advising the issuer on the appointment of other intermediaries, lead manager shall independently assess the capability and the capacity of the various intermediaries to handle the issue. Wherever required, the issuer shall be advised by the lead manager to enter into a Memorandum of Understanding with the Intermediary(ies) concerned. Lead manager should ensure that bankers to the issue are appointed in the mandatory collection centres. In case of public issues, there should be at least 30 mandatory collection centres which should invariably include the places where stock exchanges have been established.

4) Issue Management Inter-se Allocation of Responsibilities Where an issue is managed by more than one lead manager, the responsibility of each lead manager shall be clearly delineated, preferably as indicated in Annexure (3). In case of under-subscription in an issue, the lead manager responsible for tying up underwriting arrangements will be held responsible for invoking underwriting obligations and for ensuring that the underwriters pay the amount of development the Inter-se Allocation of responsibilities accompanying the Due Diligence Certificate must specifically indicate the name of the lead manager responsible for this.

5) Preparing Prospectus Lead manager should ensure proper disclosures to the investors, keeping in mind their responsibilities as per Merchant Bankers Rules and Regulations. The lead manager should, therefore, not only furnish adequate disclosures but also ensure due compliance with the Guidelines for Disclosure and Investor Protection issued by SEBI which also specifies the

contents of prospectus as well as application form. The application form should contain necessary details and instructions to applicants to mention the: l number of application form on the reverse of the instruments to avoid misuse of instruments submitted along with the applications for share/debentures in public issues. l particulars relating to savings bank/current account number and the name of the bank with whom such account is held, to enable the Registrars to print the said details in the refund orders after the names of the payees. Suitable Instructions to investors in this behalf in the application form under the head "How to apply" should be incorporated.

6) Submission of Draft Offer Documents The Lead Manager shall hand over not less than 25 copies of the draft offer, document to SEBI and also to the Stock Exchange(s) where the issue is proposed to be listed. The Lead Manager shall submit to SEBI the Draft Prospectus in a computer floppy. Copies of the Draft Prospectus will be made available by the Lead Managers/Stock Exchange to prospective investors. After a period of 21 days from the date the draft prospectus was made public, the Lead Manager shall file with SEBI a statement giving a list of complaints received by it form SEBI and any amendment done in the document.

7) Launching of a Public Issue Once the legal formalities and statutory permission for Issue of Capital are complete, the process of marketing the Issue starts. Lead Manager has to arrange for distribution of public issue stationery to various collecting banks, brokers, investors, etc. Public Issue is launched formally by conducting Press Conference, Brokers Meets, issuing advertisements in various newspapers and mobilising Brokers and Sub-Brokers.

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

Finalisation of Basis of Allotment (BOA): In case of a public offering, besides post-issue lead-manager, registrar to the issue and regional stock-exchange officials, association of public representative is required to participate in the finalisation of Basis of Allotment

Data of accepted applications is finalised and Regional Stock Exchanges are approached for finalisation of BOA.

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

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

17. a) Elucidate the important steps taken by SEBI for Regulating Mutual Funds in India.

14 Important Steps Taken by SEBI for Regulating Mutual Funds in India

Important steps taken by SEBI for the regulation of mutual funds are listed below:

(1) Formation:

Certain structural changes have also been made in the mutual fund industry, as part of which mutual funds are required to set up asset management companies with fifty percent independent directors, separate board of trustee companies, consisting of a minimum fifty percent of independent trustees and to appoint independent custodians.

This is to ensure an arm's length relationship between trustees, fund managers and custodians, and is in contrast with the situation prevailing earlier in which all three functions were often performed by one body which was usually the sponsor of the fund or a subsidiary of the sponsor.

Thus, the process of forming and floating mutual funds has been made a tripartite exercise by authorities. The trustees, the asset management companies (AMCs) and the mutual fund shareholders form the three legs. SEBI guidelines provide for the trustees to maintain an arm's length relationship with the AMCs and do all those things that would secure the right of investors.

With funds being managed by AMCs and custody of assets remaining with trustees, an element of counter-balancing of risks exists as both can keep tabs on each other.

(2) Registration:

In January 1993, SEBI prescribed registration of mutual funds taking into account track record of a sponsor, integrity in business transactions and financial soundness while granting permission.
This will curb excessive growth of the mutual funds and protect investor's interest by registering only the sound promoters with a proven track record and financial strength. In February 1993, SEBI cleared six private sector mutual funds viz. 20th Century Finance Corporation, Industrial Credit & Investment Corporation of India, Tata Sons, Credit Capital Finance Corporation, Financial Services and Apple Industries.

3) Documents:

The offer documents of schemes launched by mutual funds and the scheme particulars are required to be vetted by SEBI. A standard format for mutual fund prospectuses is being formulated.

(4) Code of advertisement:

Mutual funds have been required to adhere to a code of advertisement.

(5) Assurance on returns:
SEBI has introduced a change in the Securities Control and Regulations Act governing the mutual funds. Now the mutual funds were prevented from giving any assurance on the land of returns they would be providing. However, under pressure from the mutual funds, SEBI revised the guidelines allowing assurances on return subject to certain conditions.

(6) Minimum corpus:
The current SEBI guidelines on mutual funds prescribe a minimum start-up corpus of Rs.50 crore for an open-ended scheme, and Rs.20 crore corpus for closed-ended scheme, failing which application money has to be refunded.

The idea behind forwarding such a proposal to SEBI is that in the past, the minimum corpus requirements have forced AMCs to solicit funds from corporate bodies, thus reducing mutual funds into quasi-portfolio management outfits. In fact, the Association of Mutual Funds in India (AMFI) has repeatedly appealed to the regulatory authorities for scrapping the minimum corpus requirements.

(7) Institutionalisation:
The efforts of SEBI have, in the last few years, been to institutionalise the market by introducing proportionate allotment and increasing the minimum deposit amount to Rs.5000 etc. These efforts are to channel the investment of individual investors into the mutual funds.

(8) Investment of funds mobilised:
In November 1992, SEBI increased the time limit from six months to nine months within which the mutual funds have to invest resources raised from the latest tax saving schemes. The guideline was issued to protect the mutual
funds from the disadvantage of investing funds in the bullish market at very high prices and suffering from poor NAV thereafter.

(9) Investment in money market:
SEBI guidelines say that mutual funds can invest a maximum of 25 per cent of resources mobilised into money-market instruments in the first six months after closing the funds and a maximum of 15 per cent of the corpus after six months to meet short term liquidity requirements.

Private sector mutual funds, for the first time, were allowed to invest in the call money market after this year's budget. However, as SEBI regulations limit their exposure to money markets, mutual funds are not major players in the call money market. Thus, mutual funds do not have a significant impact on the call money market.

(10) Valuation of investment:
The transparent and well understood declaration or Net Asset Values (NAVs) of mutual fund schemes is an important issue in providing investors with information as to the performance of the fund. SEBI has warned some mutual funds earlier of unhealthy market

(11) Inspection:
SEBI inspect mutual funds every year. A full SEBI inspection of all the 27 mutual funds was proposed to be done by the March 1996 to streamline their operations and protect the investor's interests. Mutual funds are monitored and inspected by SEBI to ensure compliance with the regulations.

(12) Underwriting:

In July 1994, SEBI permitted mutual funds to take up underwriting of primary issues as a part of their investment activity. This step may assist the mutual funds in diversifying their business.

(13) Conduct:

In September 1994, it was clarified by SEBI that mutual funds shall not offer buy back schemes or assured returns to corporate investors. The Regulations governing Mutual Funds and Portfolio Managers ensure transparency in their functioning.

(14) Voting rights:
In September 1993, mutual funds were allowed to exercise their voting rights. Department of Company Affairs has reportedly granted mutual funds the right to vote as full-fledged shareholders in companies where they have equity investments.

17.b)What are the different methods of marketing securities?
The Different Methods of Marketing Securities

Following are the various methods being adopted by corporate entities for marketing the securities in the New Issue Market:

- Pure Prospectus Method, Offer for Sale Method, Private Placement Method
- Initial public Offers (IPOs) Method, Rights Issue Method, Bonus Issue Method
- Book-building Method, Stock Option Method and Bought-out Deals Method

Pure prospectus Method

The method whereby a corporate enterprise mops up capital funds from the general public by means of an issue of a prospectus, is called 'Pure Prospectus Method'. It is the most popular method of making public issue of securities by corporate enterprises.

Features

Exclusive subscription: Under this method, the new issues of a company are offered for exclusive subscription of the general public.

Issue Price: Direct officer is made by the issuing company to the general public to subscribe to the securities as a stated price.

Underwriting: Public issue through the ‘pure prospectus method’ is usually underwritten. This is to safeguard the interest of the issuer in the event of an unsatisfactory response from the public.

Prospectus: A document that contains information relating to the various aspects of the issuing company, besides other details of the issue is called a ‘Prospectus’. The document is circulated to the public. The general details include the company’s name and address of its registered office, the names and addresses of the company’s promoters, manager, managing director, directors, company secretary, legal adviser, auditors, bankers, brokers, etc

Offer for Sale Method

Where the marketing of securities takes place through intermediaries, such as issue houses, stockholders and others, it is a case of ‘Offer for sale Method’

Features

Under this method, the sale of securities takes place in two stages. Accordingly, in the first stage, the issuer company makes an end-block sale of securities to intermediaries such as the issue houses and share brokers of an agreed price. Under the second stage, the securities are re-sold to ultimate investors at a market-related price.The issue is also underwritten to ensure total subscription of the issue. The biggest advantage of this method is that it saves the issuing company the hassles involved in selling the shares to the public directly through prospectus

Private Placement Method

A method of marketing of securities whereby the issuer makes the offer of sale of individuals and institutions privately without the issue of a prospectus is known as ‘Private Placement Method.

Features

Under this method, securities are offered directly to large buyers with the help of share brokers. This method works in a manner similar to the ‘Offer for Sale Method’ whereby securities are first sold to intermediaries such as issues houses, etc.

Initial Public Offer (IPO) Method

The public issue made by a corporate entity for the first time in its life is called 'Initial public Offer' (IPO), Under this method of marketing, securities are issue to successful applicants on the basis of the orders placed by them, through their brokers.

When a company whose stock is not publicly traded wants to offer that stock to the general public, it takes the form of 'Initial public offer'. The job of selling the stock is entrusted to a popular intermediary, the underwriter. The underwriters charge a fee for their services.Stocks are issued to the underwriter after the issue of prospectus which provides details of financial and business information as regards the issuer.The issuer and the underwriting syndicate jointly determine the price of a new issue. IPO stock at the release price is usually not available to most of the public. Good relationship between, the broker and the investor is a pre-requisite for the stock being acquired.

Full disclosure of all material information in connection with the offering of new securities must be made as part of the new offerings. A statement and preliminary prospectus (also known as a red herring) containing the following information is to be filled with the Registrar of Companies:

1. A description of the issuer's business.

2. The names and addresses of the Key company officers, with salary and a 5-year business history on each.

3. The amount of ownership of the key officers

4. Any legal proceedings that the company is involved in

The essential steps involved in this method of marketing of securities are as follows:

1. **Order:** Broker receives order from the client and places orders on behalf of the client with the issuer.

2. **Share Allocation**: The issuer finalizes share allocation and informs the broker regarding the same.

3. **The Client:** The broker advises the successful clients of the share allocation. Clients then submit the application forms for shares and make payment to the issuer through the broker.

4. **Primary issue account**: The issuer opens a separate escrow account (primary issue account) for the primary market issue. The clearing house of the exchange debits the primary issue account of the broker and credits the issuer's account.

5. **Certificates:** Certificates are then delivered to investors. Otherwise depository account may be credited.

Rights issue Method

Where the shares of an existing company are offered to its existing shareholders. It takes the form of rights issue. Under this method, the existing company issues shares to its existing shareholder sin proportion in the number of shares already held by them.

The relevant guidelines issued by the SEBI in this regard are as follow Shall be issued only by listed companies.

1. Announcement regarding rights issue once made, shall not be withdrawn and where withdrawn, no security shall be eligible for listing up to 12 months.

2. Underwriting as to rights issue is optional and appointment of Registrar is compulsory.

3. Appointment of category I Merchant Bankers holding a certificate of registration issued by SEBI shall be compulsory.

4. Rights share shall be issued only in respect of fully paid share.

5. Letter of Offer shall contain disclosures as per SEBI requirements.

6. Issue shall be kept open for a minimum period of 30 days and for a maximum period of 60 days.

7. A ‘No complaints Certificate’ is to be filed by the Legal Merchant Banker’ with the SEBI after 21 days from the date of issue of the document.

8. Obligatory for a company where increase in subscribed capital is necessary after two years of its formation of after one year of its first issue of shares, whichever is earlier (this requirement may be dispensed with by a special resolution).

Bonus Issues Method

Where the accumulated reserves and surplus of profits of a company are converted into paid up capital, it takes the form of issue of bonus shares. It merely implied capitalization of existing reserves and surplus of a company.

Issue under Section 205 (3) of the companies Act, such shares is governed by the guidelines issued by the SEBI (applicable of listed companies only) as follows:

1. **Reservation:** In respect of FCDs and PCDs, bonus shares must be reserved in proportion to such convertible part of FCDs and PCDs. The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issues were made.

2. **Reserves:** the bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only.

3. **Dividend mode**: the declaration of bonus issue, in lieu of dividend, is not made.

4. **Fully paid:** The bonus issue is not made unless the partly paid shares, if any are made fully paid-up.

5. **No default**: The Company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof and has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

6. **Implementation:** A company that announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of 6 months from the date of such approval and shall not have the option of changing the decision.

7. **The articles**: The articles of Association of the company shall contain a provision for capitalization of reserves, etc. if there is no such provision in the articles, the company shall pass a resolution at is general body meeting making provision in the Articles of Association for capitalization.

8. **Resolution:** consequent to the issue of bonus shares if the subscribed and paid-up capital exceeds the authorized share capital, the company at its general body meeting for increasing the authorized capital shall pass a resolution.

Book-building Method

A method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the 'bids' received from the prospective shareholders by the lead merchant bankers is known as 'book-building method'.

The option of book-building is available to all body corporate, which are otherwise eligible to make an issue of capital of the public. The initial minimum size of issue through book-building route was fixed at Rs.100 crores.

18.a) Narrate the problems of Merchant Bankers.
The problem with merchant banking is not allowing youthfulprofessionals into the merchant banking business. Even thoughmerchant banking is vast it needs more acceptable expertise to provide more services**.**

PERSONNEL The merchant bankers in the country have organised themselves, with high overheads, to retain their personnel

BIAS IN FAVOUR OF THE ISSUING COMPANY A merchant banker is supposed to be an intermediary answerable to the investor for proper appraisal of the project. But things are not going by the book. Merchant bankers have shown a definite bias towards the issuer company.

JUSTIFICATION OF PREMIUM Now the responsibility shifts to the lead manager for the justification of the price which means that the pricing is done up front and it is forced on to the investor.

DISCLOSURE NORMS A general feeling among the investing fraternity is that the disclosure norms in India needs a total revamping. More importantly there should be strict enforcement of the laws Prospectus in India get cleared ever though 50 percent of the project costs are applied towards intangibles like pre-operation expenses, miscellaneous expenses, preliminary expenses, and contingencies, such a thing can never happen abroad.

INFORMATION ACCESSIBILITY Another important problem is the information accessibility in the Indian system.

PROJECT APPRAISAL Next important rung of the issue ladder is the project appraisal by the lead managers. Based on the viability and feasibility of the project, the lead manager goes about his business of pricing and marketing of the issue.

DUE DILIGENCE In routine businesses the only policy for survival is - "the client is always right". Give what the client asks for and carry on with the business else lose the client to your competitor.

LACK OF STAFF As far as SEBI is concerned, while vetting the offer document, it relies heavily on the certification made by the lead manager.

FREE PRICING Under the erstwhile controller of capital issues regime, an issuer would not have been permitted to charge a price of more than 6-7 times of its last three years' average earnings [EPS].

UNDERWRITING Earlier, underwriting only amounted to putting the signature on the prospectus and collecting the commission.
WORK CULTURE OF MERCHANT BANKERS Another level of inefficiency among the work culture of merchant bankers, is the in-fightings across there own branches and head office

18 b) Enumerate the various qualities required for a Merchant Banker?
Qualities of Merchant Banker

A merchant banker must have certain qualities necessary to perform his designated functions. The essential qualities of a merchant banker are generally as follows: (a) He must have expertise, (b) He must have integrity and (c) He must be capable of building up the requisite banker-customer relationship.

Functions of Merchant Banker

A merchant banker performs many functions. Some of the important functions undertaken by a merchant banker are as follows:

- Underwriting of initial public offering of shares and debentures,
- Appraising, promoting and financing domestic or overseas projects by raising resources in the form of equity, debenture and long-term loans;
- Extending assistance for and participating in international consortia to raise foreign currency loans;
- Taking deposits and participating in money market operations including foreign exchange dealings;
- Assisting in raising of Capital by means of private finance, right issues, public offer for sale or issue of loan capital;
- Providing advice or consultancy to the corporate sector in the areas of finance, investment, capital and management structure etc;
- Offering advisory services and managing the investment portfolios of individuals, socities, trusts etc. for promotion of investment and
- Maintaining relations with the government, semi-government, public and private agencies.

XXXXXXXXXXXXXXXXXXXXXX

Reg.No……………………

(17MBAPF303C)

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)

(Established Under section 3 of UGC Act 1956)

Coimbatore – 641021

(For the candidates admitted from 2017 onwards)

II MBA – III SEMESTER

Continuous Internal Assessment-II – October 2018

FINANCIAL SERVICES MANAGEMENT

Date: 9.10.2018 **Time: 2hours**

Session: AN **Maximum marks: 50**

PART – A (15 X 1 = 15 Marks)

ANSWER ALL THE QUESTIONS

1. CRISIL was born during the year
   A. 1987 B. 1991
   C. 1994 D. 1996
2. The rating is primarily aimed at furnishing guidance to
   A. Investors B. Creditors
   C. Both D. Market
3. Whether Rating is made compulsory for all corporate bodies intend to raise funds
   A. TRUE B. Need Arises
   C. To prove the strength D. All the factors
4. Mutual funds can offer guaranteed returns
   A. TRUE B. FALSE
   C. Not often D. At Times
5. Credit Rating agencies fix interest rates on bonds or debentures issued by companies.
   A. FALSE B. TRUE
   C. At Times True D. Depends
6. RBI and SEBI ___________ the eligibility criteria for financial instruments
   A. Decide B. Determines
   C. Fixes D. Do not determine
7. In ___________ leasing the lessee is allowed to exchange equipment leased out whenever the original asset has to be sent to the lessor for some repair and maintenance
   A. Swap B. Wrap
   C. Import D. Balloon
8. IRR, NPV and Pay Back method are the means of evaluating a __________ lease
   A. Finance B. Equipment
   C. Dry D. Wet
9. Which of these is not a credit rating agency?
   A. Moody's B. Standard &Poor's
   C. Price water house D. ICRA
10. What type of lease that all risks and rewards incident to ownership of an asset?
    A. Financial B. Operating
    C. Sale & Lease Back D. Sale Aid Lease
11. Full Payment Lease and True Lease are the ____ variants of Financial Lease
    A. Two B. methods
    C. Factors D. parameters
12. The lessee is allowed to exchange equipment leased out whenever the original asset has to be sent to the lessor for some repair or maintenance
    A. Swap B. Wrap
    C. Imported D. Balloon

13. Where two personnel enter into agreement, whereby the lessor agrees to provide assets or equipments for use by the lessee over a period of time for which the lessee agrees to pay a consideration regularly

A. Leasing B. Hire Purchase
C. Instalment D. Loan

14.________ lease which has zero residual value at the end of the lease period

A. Close end B. Balloon
C. Open end D. Swap

15. Disadvantages of Leasing shall not include

A. No Depreciation Allowance B. Involve Higher Cost
C. Not a suitable mode of Finance D. Low Cost of Operation

PART – B (3 X 8= 24 Marks)

ANSWER ALL THE QUESTIONS

16. a) Differentiate between Factoring and Discounting.

(OR)

b) Explain the benefits of Factoring.

17. a) Comment on the contents of a Lease agreement.

(OR)

b) Enumerate the various disadvantages of Lease

18. a) Enumerate the various features of Hire Purchase Agreement

(OR)

b) Narrate the difference between Hire Purchase, Instalment and Leasing.

PART – C (1 X 11= 11 Marks)

19. Case Study:

Factoring Service in India is of recent origin. It owes its genesis to the recommendations of the Kalyanasundaram Study Group appointed by the RBI in 1989. Pursuant to the acceptance of these recommendations, the RBI issued guidelines for factoring services in 1990.

Having this as a “Factor” you are asked to justify on par with the Kalyanasundaram Study Group.

Subject code: 17MBAPF303C

Subject Name: Financial Service Management

Class: II MBA – FINANCE ELCTIVE

No of Copies: 40

Prepared By – Mrs.PADMAAVATHY.PA, Assistant Professor

KARPAGAM UNIVERSITY

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed University, Established Under Section 3 of UGC Act, 1956)

II MBA – Continuous Internal Assessment – II – OCTOBER 2018

FINANCIAL SERVICES MANAGEMENT

ANSWER KEY

PART –A

1) a.1987
2) c. Both
3) a. True
4) b. False
5) b. True
6) b. determines
7) a. Swap
8) a. Finance
9) d.ICRA
10) d. Sales aid Lease
11) a.Two
12) a.Swap
13) a. Leasing
14) b. balloon
15) d.Low cost of operation

PART –B

16. a) Differentiate between Factoring and Discounting.

Basis	Bill discounting	Factoring
Meaning	Bill discounting means to trade bill before it becomes due for payment at par value.	Factoring means to sell its bool debt to the financial transaction to the factoring company at a discount.
Existence	Bill discounting comes under the Negotiable instrument act, 1881.	There is no such specific law for factoring.
Settlement of finance	In bill discounting, the bill is discounted and paid when the transaction takes place.	In factoring, the financer gives a maximum amount as an advance when a transaction takes place the remaining amount at the time of settlement.
Parties involved	In bill discounting there is a drawer, drawee, and a payee.	In factoring, there is a factoring company, debtor and a customer.
Fees	A financer charges fees in the form of discounting charges or interest.	Financer gets fees in the form of interest for the financial services and commission for extra services facilitate.

16. b) Explain the benefits of Factoring.

1.Guarantee

The risk that businesses most often face is certainly that of being unable to make collections.

2.Liquidity

The financing that you receive by assigning your receivables through a factoring company regularizes your business's cash flow, increases the working capital you can create, and makes your balance sheet more liquid.

3.Credit İnvestigation

By the reliable information about a buyer's credit worthiness, financial strength, and market reputation, you can minimize your collection risks while developing a high-quality customer portfolio of your own.

4.Time

In business, wasted time is a luxury no one can afford. Investigating a customer's credit record, managing and making collections, handling credit procedures… They all take time–time which you save by taking advantage of factoring services and which you can put to better use by developing business plans and creating competitive advantages for your own business.

5.Lower Costs

Factoring reduces your bookkeeping costs and your overhead expenses. Factoring allows you to make cash payments to your suppliers, which means you can take advantage of discounts and reduce your production costs.

6.Financial Strength

Factoring makes it possible for a business to finance its operations from its own receivables. Your average collection time will be lowered as will your commercial payables, which means that your company's financial structure will be stronger. You can use your company's own resources to finance its own needs and increase its business.

17. a)) Comment on the contents of a Lease agreement.

A lease agreement is entered into between a lessor and a lessee. The agreement contains the terms and conditions subject to which the property has been leased out by the lessor to the lessee. Before entering into a lease agreement, a lessee should ensure the lessor has proper title to the property. The lessor should either be the owner of the property or an authorised po ..
Lease agreement is a written agreement and also known as lease deed which starts the legal relationship between the owner of the assets, called lessor and user of the assets, called lessee. Under the leasing agreements, the company acquires the right to use the asset without holding the title to it.

Contents of lease agreement are:

1)Description and cost of equipment

2)Commencement date for lease contract.

3)Amount of lease rentals

4)Mode of Payments

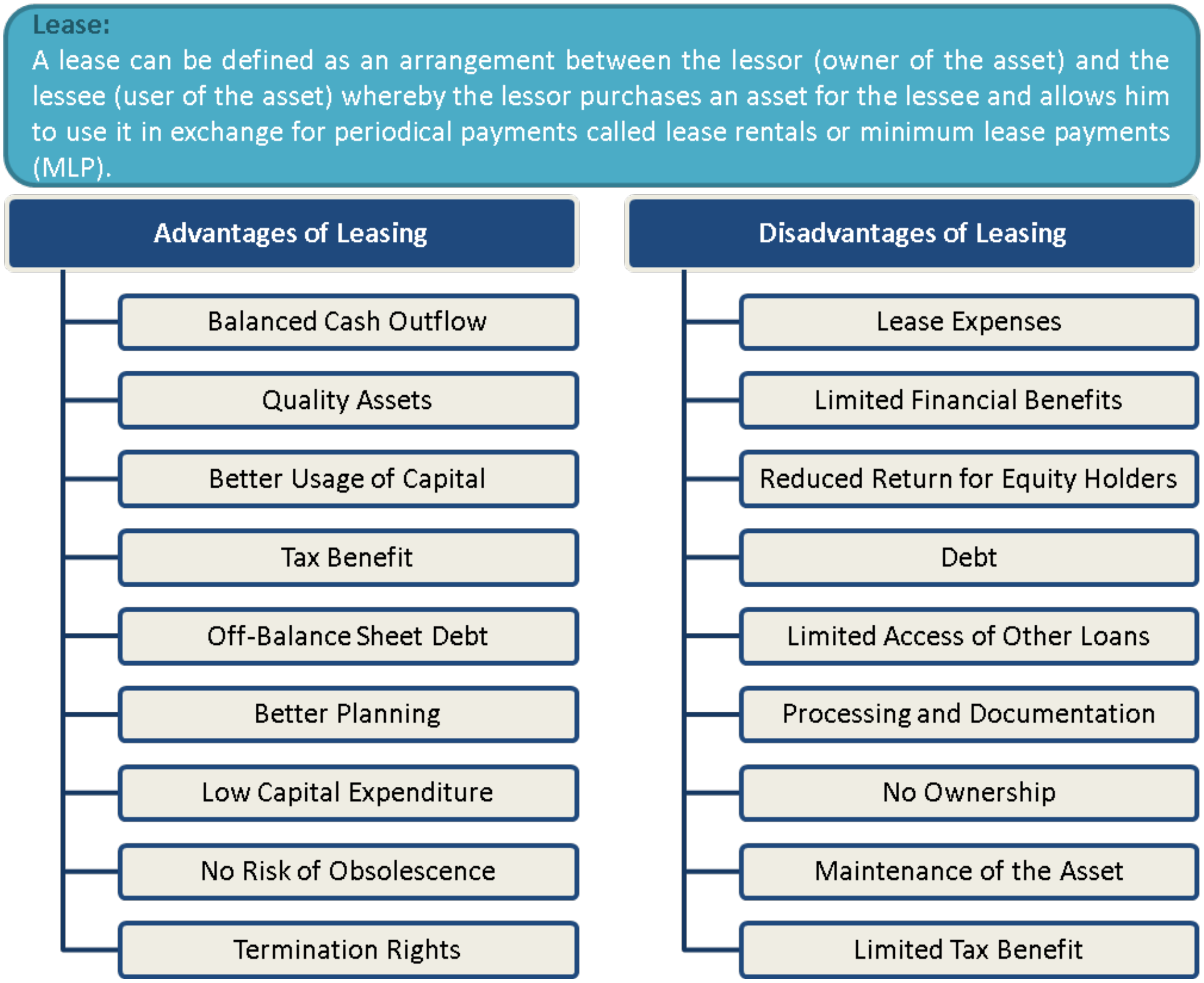
5)Fixed period of lease, renewal options and the terms during secondary period as to the amount of lease rentals or purchase option.

6)Guarantee for payment of lease rental by lessee.

7)Variation of lease rentals.

8)Termination of lease agreement in the event of certain occurrences.

17.b) Enumerate the various disadvantages of Lease.



18.a) Enumerate the various features of Hire Purchase Agreement

Hire purchase is an option for those buyers who cannot pay the whole amount of his or her purchase. Hire purchase refers to an agreement where the buyer of a good can take goods on a monthly rental basis and once the rent equals original price of a good in addition to the interest then the buyer may exercise his or her option to buy the goods at a predetermined price or return the goods to the owner. Given below are some of the features of hire purchase –

1. The person who has hire the goods will give regular installment or rent to the owner of the good which will include some portion of principal amount and some portion of interest as agreed by both the parties.
2. The ownership of good passes only when the person has paid the last installment of the goods which he or she has hired.
3. Under hire purchase system the buyer can return the goods to the seller if he or she does not want to continue with the agreement.
4. In case of hire purchase the person who has taken the good on hire cannot transfer the goods to a third party as he or she does not have the ownership of the goods.

18 b) Narrate the difference between Hire Purchase, Instalment and Leasing.

Points of Distinction	Leasing	Hire Purchase
Ownership	Lessor is the owner until the end of the agreement	Hirer has the option of purchasing the asset at the end of the agreement
Duration	Done for longer duration	Done for a shorter duration
Depreciation	Lessor claims the depreciation	Hirer claims the depreciation
Payments	Rental payments are the cost of using the asset	Payments include the principal amount and the effective interest for the duration of the agreement
Tax Impact	Lease rentals categorized as expenditure by the lessee	Only interest component is categorized as expenditure by the hirer
The Extent of Financing	Complete financing	Partial financing
Repairs and Maintenance	Responsibility of the lessee in the financial lease, and of the lessor in operating lease	Responsibility of the hirer

HIRE PURCHASE VS. INSTALLMENT PURCHASE

Both hire purchase and installment purchase may look similar as both are a method of finance and payment in both the cases is made in smaller parts. In that impression, it is interesting to know the differences between the two. Following are the points of differences in these two methods of financing.

TIME OF PURCHASE AND OWNERSHIP

In the case of hire purchase, the act of purchasing takes place only when whole payment is made to the financing company. It means after making payment of the last hire charges / installment only, the goods are considered purchased or if the buyer or hirer prepays in a lump sum in between the agreed period for purchasing the goods. In the case of installment purchase, the purchase happens as soon as the agreement between the buyer and financing company is entered into. In hire purchase, both ownership and purchase is delayed till the complete payment whereas in installment purchase, purchase and ownership take place before the complete payment.

OPTION / RIGHT TO TERMINATE

The hirer, in the case of hire purchase agreement, has an option / right to terminate the agreement and return the goods whereas there is no such right or option available to the buyer in case of installment purchase. This is because the purchase has not taken place in case of hire purchase but it takes place at the beginning only.

INSTALLMENT/HIRE CHARGES

The monthly or period payment in installment purchase is termed as installment whereas, in hire purchase arrangement, it is called hire charges. Installment derives its value from the length of time, the sale value of an asset, and interest rate whereas the hire charges is a function of two additional factors viz. option of termination and repairs and maintenance. Ideally, the installment should be less than the hire charges for the same asset. Therefore, hire purchase is an expensive system compared to installment purchase.

RISK, REPAIR AND MAINTENANCE RELATED TO ASSET

In hire purchase, all the risks are born by the financing company till the last payment by hirer because it is the official owner of the asset till that time. In installment purchase, the risks are borne by the buyer from day one. Similarly, repair and maintenance is the headache of financier in the case of hire purchase and buyer in case of installment purchase.

RIGHT TO SELL OR TRANSFER

The right to sell or transfer is always exercised by the owner of the assets. In the case of hire purchase, this right lies with the financing company or seller as the case may be because they are the owners of the asset. In the case of installment purchase, it is with the buyer because he becomes the owner on the day he signs the agreement.

THE DEFAULT OF INSTALLMENT/HIRE CHARGES

When a hirer defaults in the payment of hire charges, the financier has the right to forfeit the money paid till that date and take back the possession of the goods. Whereas in installment purchase, the installment paid are not forfeited and the financier is liable to receive the remaining dues.

XXXXXXXXXXXXXXXXXXXXXX