MBA	2018 - 2019
Semester - III

18MBAPF303B **FINANCIAL MARKETS AND SERVICES** **4H-4C**

Instruction Hours / week: L: 4 T: 0 P: 0 **Marks: Internal: 40 External: 60 Total: 100**

End Semester Exam: 3 Hours

Course Objectives:

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

Course Outcome:

Explain in detail the organisation, products, services, and operations of a company in the financial services sector. Provide insights for improvement in the performance of a company in the financial services sector.

UNIT- I : Financial Markets

Overview of Financial systems In India – Structure, Regulation Role And Functions Of Financial Systems – Financial Instruments – Financial Markets – Capital Markets & Money Markets – Interlink Between Money Market & Capital Market – Characteristics Of Financial Markets – Functions Of Stock Exchange – Introduction To Forex.

Depositories - dematerialisation services – need and operations –role of NSDL&CSDL.

UNIT – II: Financial Services

Objectives of financial services – types of financial services (fund based and fees based) – capital market services & money market services – intermediaries: banking financial corporations, non banking financial corporations & insurance corporations- financial services sector problems and reforms, growth of financial services in India.

Unit III LEASING AND HIRE PURCHASE

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.

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.

UNIT IV Factoring and Forfeiting

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 V Venture Capital, Credit Rating & Mutual fund

Venture capital: growth of venture capital in India- financing pattern – legal aspects and guidelines for venture

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: **19MBAPF303C** Semester: **III** Year: **2018-2020 Batch**
Subject: **Financial Markets & Services t- Lesson Plan**

UNIT - 1			
S. No	**Lecture Hours**	**Contents**	**References**
1.	1	Overview of financial systems in India- structure , regulation	T2: PgNo.: 1.14-1.22
2.	1	Role and functions of financial systems	T2: PgNo.: 1.3-1.4
3.	1	Financial Instruments- Financial Markets- capital Markets & Money markets	T2: PgNo.: 1.4-1.6
4.	1	Interlink between money market and capital market, Characteristics of financial markets	T2: PgNo.: 1.4-1.6
5.	1	Functions of stock exchange-Introduction to forex	T2: PgNo.: 1.14-1.22
6.	1	Depositories- Dematerialization services- Need and Operations	T2: PgNo.: 1.24-1.32
7.	1	Role of NSDL & CDSL	T2: PgNo.: 1.24-1.32
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	Objectives of financial services – type of financial services (fund based and fee based)	T2: PgNo.: 2.14-2.22
2.	1	Capital market services and money market Services	T2: PgNo.: 2.3-2.4
3.	1	Intermediaries- banking Financial Corporation	T2: PgNo.: 2.4-2.6
4.	1	Non- banking financial Corporations	T2: PgNo.: 2.4-2.6
5.	1	Insurance corporations	T2: PgNo.: 5.14-5.22
6.	1	Financial Service Sector Problems and Reforms	T2: PgNo.: 16.1
7.	1	Growth of financial services in India	T2: PgNo.:16.5.8
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	Leasing- History and development- Concept and classification – types	T1: PgNo.: 2.14-2.22
2.	1	Advantages and Disadvantages,- Legislative framework- Supplier	T1: PgNo.: 2.3-2.4
3.	1	Lessor, lessee Relationship- sub lease- Default and remedies	T1: PgNo.: 2.4-2.6
4.	1	Lease Evaluation in Lessee and lessor point of view	T1: PgNo.: 2.4-2.6
5.	1	Hire Purchase- Concept and classifications, Rate of interest , Methods of reporting adopted for hire purchase transactions	T1: PgNo.: 5.14-5.22
6.	1	Legal aspects, Tax implication framework for financial evaluation	T1: PgNo.: 16.1
7.	1	Tax implication frame work for Financial Evaluation.	T1: PgNo.:16.5.8
8.	1	Case Study	-
9	1	Recapitulation & Discussion on important questions	-
Total number of hours planned for Unit 3			**9**
UNIT - 4			
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 no. of Hours planned for Unit 4			**9**
UNIT - 5			
1.	1	Venture Capital- growth of venture capital in India – financing pattern	T3: PgNo.: 6.1
2.	1	Legal aspects and guidelines for venture capital	T3: PgNo.: 7.1
3.	1	Credit rating – Importance Credit rating Agency (CRA), CRISIL, ICRA CARE,	T3: PgNo.: 7.15
4.	1	Credit rating process, Regulation to guide CRA	T3: PgNo.: 6.11
5.	1	Mutual funds- concepts and objectives, functions and portfolio classification	T4: PgNo.: 6.12
6.	1	Guidelines for mutual funds	T4: PgNo.:6.15,6.18
7.	1	Working of public and private mutual funds in India	T4: PgNo.: 6.22
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. (2013). *Financial Services* (7th edition). New Delhi: Tata McGraw Hill
T2: Ramesh Babu, G. (2009). *Indian Financial System.* New Delhi: Himalaya Publishing House.

T3: Shanmugam, R. (2010). *Financial Services*. New Delhi: Wiley India Pvt Ltd.

T4: Gurusamy.S(2009), *Merchant banking and financial Service,*(3rd Edition), New Delhi : Tata Mc Graw Hill Eductaion Pvt Ltd

T5: Gordon, E.Natarajan (2013), *Financial Markets & Services*, New Delhi, Himalaya Publications. .

UNIT-I- OVERVIEW OF FINANCIAL SYSTEM IN INDIA

SYLLABUS

Unit I
Overview of financial system in India – Structure, regulation, role and functions of financial systems—financial instruments- financial markets- capital market and money market – interlink between money market and capital market- characteristics of financial market – functions of stock exchange- -introduction to forex- depositories – dematerilaisation services – need and operations – Role of NSDL & CDSL.

Overview of financial system in India

Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. This paper discusses the meaning of finance and Indian Financial System and focus on the financial markets, financial intermediaries and financial instruments. The brief review on various money market instruments are also covered in this study.

The term "finance" in our simple understanding it is perceived as equivalent to 'Money'. We read about Money and banking in Economics, about Monetary Theory and Practice and about "Public Finance". But finance exactly is not money, it is the source of providing funds for a particular activity. Thus public finance does not mean the money with the Government, but it refers to sources of raising revenue for the activities and functions of a Government. Here some of the definitions of the word 'finance', both as a source and as an activity i.e. as a noun and a verb.

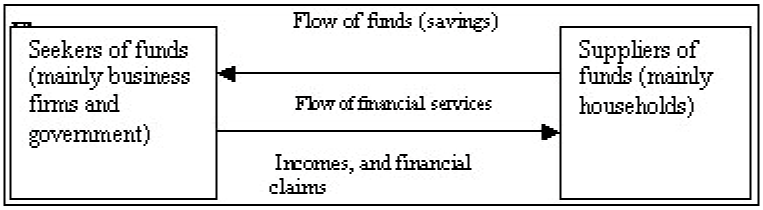
The American Heritage® Dictionary of the English Language, Fourth Edition defines the term as under-
1:"The science of the management of money and other assets.";
2: "The management of money, banking, investments, and credit. ";
3: "finances Monetary resources; funds, especially those of a government or corporate body"
4: "The supplying of funds or capital."
Finance as a function (i.e. verb) is defined by the same dictionary as under-
1:"To provide or raise the funds or capital for": financed a new car
2: "To supply funds to": financing a daughter through law school.
3: "To furnish credit to".

Another English Dictionary, "WordNet ® 1.6, © 1997Princeton University " defines the term as under-
1:"the commercial activity of providing funds and capital"
2: "the branch of economics that studies the management of money and other assets"
3: "the management of money and credit and banking and investments"
The same dictionary also defines the term as a function in similar words as under-
1: "obtain or provide money for;" " Can we finance the addition to our home?"
2:"sell or provide on credit "
All definitions listed above refer to finance as a source of funding an activity. In this respect providing or securing finance by itself is a distinct activity or function, which results in Financial Management, Financial Services and Financial Institutions. Finance therefore represents the resources by way funds needed for a particular activity. We thus speak of 'finance' only in relation to a proposed activity. Finance goes with commerce, business, banking etc. Finance is also referred to as "Funds" or "Capital", when referring to the financial needs of a corporate body. When we study finance as a subject for generalising its profile and attributes, we distinguish between 'personal finance" and "corporate finance" i.e. resources needed personally by an individual for his family and individual needs and resources needed by a business organization to carry on its functions intended for the achievement of its corporate goals.

INDIAN FINANCIAL SYSTEM

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.
There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities.
Financial System;

The word "system", in the term "financial system", implies a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance-the three terms are intimately related yet are somewhat different from each other. Indian financial system consists of financial market, financial instruments and financial intermediation. These are briefly discussed below;



FINANCIAL MARKETS

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

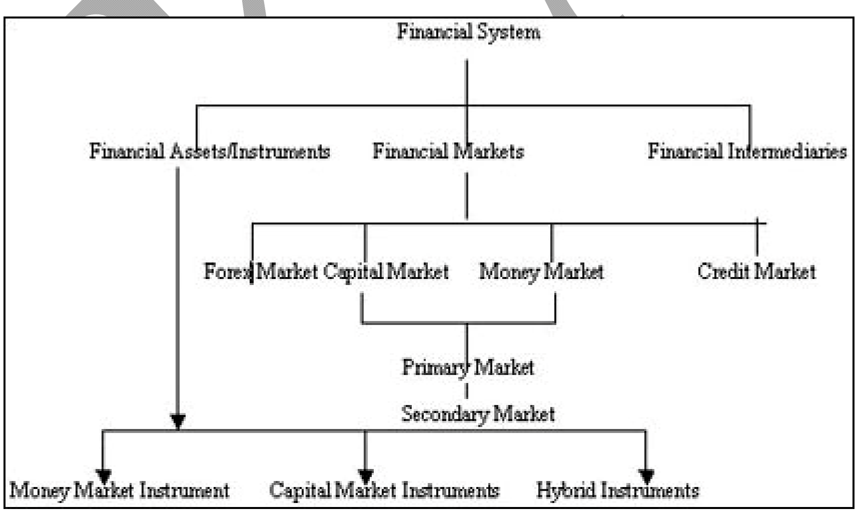
Money Market- The money market ifs a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

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

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

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

Constituents of a financial system



.FINANCIAL INTERMEDIATION

Having designed the instrument, the issuer should then ensure that these financial assets reach the ultimate investor in order to garner the requisite amount. When the borrower of funds approaches the financial market to raise funds, mere issue of securities will not suffice. Adequate information of the issue, issuer and the security should be passed on to take place. There should be a proper channel within the financial system to ensure such transfer. To serve this purpose, Financial intermediaries came into existence. Financial intermediation in the organized sector is conducted by a widerange of institutions functioning under the overall surveillance of the Reserve Bank of India. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating ink the financial markets include; investment bankers, underwriters, stock exchanges, registrars, depositories, custodians, portfolio managers, mutual funds, financial advertisers financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc. Though the markets are different, there may be a few intermediaries offering their services in move than one market e.g. underwriter. However, the services offered by them vary from one market to another.

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

FINANCIAL INSTRUMENTS

Money Market Instruments

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

Some of the important money market instruments are briefly discussed below;
1. Call/Notice Money
2. Treasury Bills
3. Term Money
4. Certificate of Deposit
5. Commercial Papers
1. Call /Notice-Money Market
Call/Notice money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call (Overnight) Money. Intervening holidays and/or Sunday are excluded for this purpose. Thus money, borrowed on a day and repaid on the next working day, (irrespective of the number of intervening holidays) is "Call Money". When money is borrowed or lent for more than a day and up to 14 days, it is "Notice Money". No collateral security is required to cover these transactions.

2. Inter-Bank Term Money

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

3. Treasury Bills.

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

4. Certificate of Deposits

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

5. Commercial Paper

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

Capital Market Instruments

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

Hybrid Instruments

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

In India money market is regulated by Reserve bank of India (www.rbi.org.in) and Securities Exchange Board of India (SEBI) [www.sebi.gov.in] regulates capital market. Capital market consists of primary market and secondary market. All Initial Public Offerings comes under the primary market and all secondary market transactions deals in secondary market. Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Secondary market comprises of equity markets and the debt markets. In the secondary market transactions BSE and NSE plays a great role in exchange of capital market instruments. (visit www.bseindia.com and www.nseindia.com).

Overview of Stock market and Stock exchanges in India

In general, the financial market divided into two parts, Money market and capital market. Securities market is an important, organized capital market where transaction of capital is facilitated by means of direct financing using securities as a commodity. Securities market can be divided into a primary market and secondary market.

PRIMARY MARKET

The primary market is an intermittent and discrete market where the initially listed shares are traded first time, changing hands from the listed company to the investors. It refers to the process through which the companies, the issuers of stocks, acquire capital by offering their stocks to investors who supply the capital. In other words primary market is that part of the capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is called an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.

SECONDARY MARKET

The secondary market is an on-going market, which is equipped and organized with a place, facilities and other resources required for trading securities after their initial offering. It refers to a specific place where securities transaction among many and unspecified persons is carried out through intermediation of the securities firms, i.e., a licensed broker, and the exchanges, a specialized trading organization, in accordance with the rules and regulations established by the exchanges.

A bit about history of stock exchange they say it was under a tree that it all started in 1875.Bombay Stock Exchange (BSE) was the major exchange in India till 1994.National Stock Exchange (NSE) started operations in 1994.

NSE was floated by major banks and financial institutions. It came as a result of Harshad Mehta scam of 1992. Contrary to popular belief the scam was more of a banking scam than a stock market scam. The old methods of trading in BSE were people assembling on what as called a ring in the BSE building. They had a unique sign language to communicate apart from all the shouting. Investors weren't allowed access and the system was opaque and misused by brokers. The shares were in physical form and prone to duplication and fraud.

NSE was the first to introduce electronic screen based trading. BSE was forced to follow suit. The present day trading platform is transparent and gives investors prices on a real time basis. With the introduction of depository and mandatory dematerialization of shares chances of fraud reduced further. The trading screen gives you top 5 buy and sell quotes on every scrip.

A typical trading day starts at 10 ending at 3.30. Monday to Friday. BSE has 30 stocks which make up the Sensex .NSE has 50 stocks in its index called Nifty. FII s Banks, financial institutions mutual funds are biggest players in the market. Then there are the retail investors and speculators. The last ones are the ones who follow the market morning to evening; Market can be very addictive like blogging though stakes are higher in the former.

ORIGIN OF INDIAN STOCK MARKET

The origin of the stock market in India goes back to the end of the eighteenth century when long-term negotiable securities were first issued. However, for all practical purposes, the real beginning occurred in the middle of the nineteenth century after the enactment of the companies Act in 1850, which introduced the features of limited liability and generated investor interest in corporate securities.

An important early event in the development of the stock market in India was the formation of the native share and stock brokers 'Association at Bombay in 1875, the precursor of the present day Bombay Stock Exchange. This was followed by the formation of associations/exchanges in Ahmedabad (1894), Calcutta (1908), and Madras (1937). In addition, a large number of ephemeral exchanges emerged mainly in buoyant periods to recede into oblivion during depressing times subsequently.

Stock exchanges are intricacy inter-woven in the fabric of a nation's economic life. Without a stock exchange, the saving of the community- the sinews of economic progress and productive efficiency- would remain underutilized. The task of mobilization and allocation of savings could be attempted in the old days by a much less specialized institution than the stock exchanges. But as business and industry expanded and the economy assumed more complex nature, the need for 'permanent finance' arose. Entrepreneurs needed money for long term whereas investors demanded liquidity – the facility to convert their investment into cash at any given time. The answer was a ready market for investments and this was how the stock exchange came into being.

Stock exchange means any body of individuals, whether incorporated or not, constituted for the purpose of regulating or controlling the business of buying, selling or dealing in securities. These securities include:

(i) Shares, scrip, stocks, bonds, debentures stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ii) Government securities; and

(iii) Rights or interest in securities.

The Bombay Stock Exchange (BSE) and the National Stock Exchange of India Ltd (NSE) are the two primary exchanges in India. In addition, there are 22 Regional Stock Exchanges. However, the BSE and NSE have established themselves as the two leading exchanges and account for about 80 per cent of the equity volume traded in India. The NSE and BSE are equal in size in terms of daily traded volume. The average daily turnover at the exchanges has increased from Rs 851 crore in 1997-98 to Rs 1,284 crore in 1998-99 and further to Rs 2,273 crore in 1999-2000 (April - August 1999). NSE has around 1500 shares listed with a total market capitalization of around Rs 9, 21,500 crore.

The BSE has over 6000 stocks listed and has a market capitalization of around Rs 9, 68,000 crore. Most key stocks are traded on both the exchanges and hence the investor could buy them on either exchange. Both exchanges have a different settlement cycle, which allows investors to shift their positions on the bourses. The primary index of BSE is BSE Sensex comprising 30 stocks. NSE has the S&P NSE 50 Index (Nifty) which consists of fifty stocks. The BSE Sensex is the older and more widely followed index.

Both these indices are calculated on the basis of market capitalization and contain the heavily traded shares from key sectors. The markets are closed on Saturdays and Sundays. Both the exchanges have switched over from the open outcry trading system to a fully automated computerized mode of trading known as BOLT (BSE on Line Trading) and NEAT (National Exchange Automated Trading) System.

It facilitates more efficient processing, automatic order matching, faster execution of trades and transparency; the scrip's traded on the BSE have been classified into 'A', 'B1', 'B2', 'C', 'F' and 'Z' groups. The 'A' group shares represent those, which are in the carry forward system (Badla). The 'F' group represents the debt market (fixed income securities) segment. The 'Z' group scrip's are the blacklisted companies. The 'C' group covers the odd lot securities in 'A', 'B1' & 'B2' groups and Rights renunciations. The key regulator governing Stock Exchanges, Brokers, Depositories, Depository participants, Mutual Funds, FIIs and other participants in Indian secondary and primary market is the Securities and Exchange Board of India (SEBI) Ltd.

Brief History of Stock Exchanges

Do you know that the world's foremost marketplace New York Stock Exchange (NYSE), started its trading under a tree (now known as 68 Wall Street) over 200 years ago? Similarly, India's premier stock exchange Bombay Stock Exchange (BSE) can also trace back its origin to as far as 125 years when it started as a voluntary non-profit making association.

News on the stock market appears in different media every day. You hear about it any time it reaches a new high or a new low, and you also hear about it daily in statements like 'The BSE Sensitive Index rose 5% today'. Obviously, stocks and stock markets are important. Stocks of public limited companies are bought and sold at a stock exchange. But what really are stock exchanges? Known also as the stock market or bourse, a stock exchange is an organized marketplace for securities (like stocks, bonds, options) featured by the centralization of supply and demand for the transaction of orders by member brokers, for institutional and individual investors.

Electronic trading

Electronic trading eliminates the need for physical trading floors. Brokers can trade from their offices, using fully automated screen-based processes. Their workstations are connected to a Stock Exchange's central computer via satellite using Very Small Aperture Terminus (VSATs). The orders placed by brokers reach the Exchange's central computer and are matched electronically.

Exchanges in India

The Stock Exchange, Mumbai (BSE) and the National Stock Exchange (NSE) are the country's two leading Exchanges. There are 20 other regional Exchanges, connected via the Inter-Connected Stock Exchange (ICSE). The BSE and NSE allow nationwide trading via their VSAT systems.

Index

An Index is a comprehensive measure of market trends, intended for investors who are concerned with general stock market price movements. An Index comprises stocks that have large liquidity and market capitalization. Each stock is given a weight age in the Index equivalent to its market capitalization. At the NSE, the capitalization of NIFTY (fifty selected stocks) is taken as a base capitalization, with the value set at 1000. Similarly, BSE Sensitive Index or Sensex comprises 30 selected stocks. The Index value compares the day's market capitalization vis-à-vis base capitalization and indicates how prices in general have moved over a period of time.

Execute an order

Select a broker of your choice and enter into a broker-client agreement and fill in the client registration form. Place your order with your broker preferably in writing. Get a trade confirmation slip on the day the trade is executed and ask for the contract note at the end of the trade date.

Need a broker

As per SEBI (Securities and Exchange Board of India.) regulations, only registered members can operate in the stock market. One can trade by executing a deal only through a registered broker of a recognized Stock Exchange or through a SEBI-registered sub-broker.

Contract note

A contract note describes the rate, date, time at which the trade was transacted and the brokerage rate. A contract note issued in the prescribed format establishes a legally enforceable relationship between the client and the member in respect of trades stated in the contract note. These are made in duplicate and the member and the client both keep a copy each. A client should receive the contract note within 24 hours of the executed trade. Corporate Benefits/Action.

Split

A Split is book entry wherein the face value of the share is altered to create a greater number of shares outstanding without calling for fresh capital or altering the share capital account. For example, if a company announces a two-way split, it means that a share of the face value of Rs 10 is split into two shares of face value of Rs 5 each and a person holding one share now holds two shares.

Buy Back

As the name suggests, it is a process by which a company can buy back its shares from shareholders. A company may buy back its shares in various ways: from existing shareholders on a proportionate basis; through a tender offer from open market; through a book-building process; from the Stock Exchange; or from odd lot holders.

A company cannot buy back through negotiated deals on or off the Stock Exchange, through spot transactions or through any private arrangement.

Settlement cycle

The accounting period for the securities traded on the Exchange. On the NSE, the cycle begins on Wednesday and ends on the following Tuesday, and on the BSE the cycle commences on Monday and ends on Friday. At the end of this period, the obligations of each broker are calculated and the brokers settle their respective obligations as per the rules, bye-laws and regulations of the Clearing Corporation. If a transaction is entered on the first day of the settlement, the same will be settled on the eighth working day excluding the day of transaction. However, if the same is done on the last day of the settlement, it will be settled on the fourth working day excluding the day of transaction.

Rolling settlement

The rolling settlement ensures that each day's trade is settled by keeping a fixed gap of a specified number of working days between a trade and its settlement. At present, this gap is five working days after the trading day. The waiting period is uniform for all trades. In a Rolling Settlement, all trades outstanding at end of the day have to be settled, which means that the buyer has to make payments for securities purchased and seller has to deliver the securities sold. In India, we have adopted the

T+5 settlement cycle, which means that a transaction entered into on Day 1 has to be settled on the Day 1 + 5 working days, when funds pay in or securities pay out takes place.

What are the advantages of Rolling Settlements?

As mentioned earlier, this is the system practiced in developed countries. Pay outs are quicker than in weekly settlements, and investors will benefit from increased liquidity. The other benefit of the modified system is that it keeps cash and forward markets separate. In the current system, the trader has five days to square off his transaction which leads to a high level of speculation as people even without funds tend to "play" the market. During volatile markets, especially in a bearish market, this often leads to a payment problem which has dogged the Indian stock exchanges for a long time. It provides for a higher degree of safety, and once mechanisms such as futures and stock-lending become popular, it would result in quality speculation and genuine investor interest.

When does one deliver the shares and pay the money to broker?

As a seller, in order to ensure smooth settlement you should deliver the shares to your broker immediately after getting the contract note for sale but in any case before the pay-in day. Similarly, as a buyer, one should pay immediately on the receipt of the contract note for purchase but in any case before the pay-in day.

Short selling

Short selling is a legitimate trading strategy. It is a sale of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller. Short sellers take the risk that they will be able to buy the stock at a more favorable price than the price at which they "sold short."

The selling of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller, Short sellers assume that they will be able to buy the stock at a lower amount than the price at which they sold short.

Auction

An auction is conducted for those securities that members fail to deliver/short deliver during pay-in. Three factors primarily give rise to an auction: short deliveries, un-rectified bad deliveries, and un-rectified company objections

Separate market for auctions

The buy/sell auction for a capital market security is managed through the auction market. As opposed to the normal market where trade matching is an on-going process, the trade matching process for auction starts after the auction period is over.

If the shares are not bought in the auction

If the shares are not bought at the auction i.e. if the shares are not offered for sale, the Exchange squares up the transaction as per SEBI guidelines. The transaction is squared up at the highest price from the relevant trading period till the auction day or at 20 per cent above the last available Closing price whichever is higher. The pay-in and pay-out of funds for auction square up is held along with the pay-out for the relevant auction.

Bad Delivery

SEBI has formulated uniform guidelines for good and bad delivery of documents. Bad delivery may pertain to a transfer deed being torn, mutilated, overwritten, defaced, or if there are spelling mistakes in the name of the company or the transfer. Bad delivery exists only when shares are transferred physically. In "Demat" bad delivery does not exist.

Stock & Exchange Board of India

REGULATION OF BUSINESS IN THE STOCK EXCHANGES

Under the SEBI Act, 1992, the SEBI has been empowered to conduct inspection of stock exchanges. The SEBI has been inspecting the stock exchanges once every year since 1995-96. During these inspections, a review of the market operations, organizational structure and administrative control of the exchange is made to ascertain whether:

- the exchange provides a fair, equitable and growing market to investors
- the exchange's organization, systems and practices are in accordance with the Securities Contracts (Regulation) Act (SC(R) Act), 1956 and rules framed there under
- the exchange has implemented the directions, guidelines and instructions issued by the SEBI from time to time
- The exchange has complied with the conditions, if any, imposed on it at the time of renewal/ grant of its recognition under section 4 of the SC(R) Act, 1956.

During the year 1997-98, inspection of stock exchanges was carried out with a special focus on the measures taken by the stock exchanges for investor's protection. Stock exchanges were, through inspection reports, advised to effectively follow-up and redress the investors' complaints against members/listed companies. The stock exchanges were also advised to expedite the disposal of arbitration cases within four months from the date of filing.

During the earlier years' inspections, common deficiencies observed in the functioning of the exchanges were delays in post trading settlement, frequent clubbing of settlements, delay in conducting auctions, inadequate monitoring of payment of margins by brokers, non-adherence to Capital Adequacy Norms etc. It was observed during the inspections conducted in 1997-98 that there has been considerable improvement in most of the areas, especially in trading, settlement, collection of margins etc.

Dematerialization

Dematerialization in short called as 'demat' is the process by which an investor can get physical certificates converted into electronic form maintained in an account with the Depository Participant. The investors can dematerialize only those share certificates that are already registered in their name and belong to the list of securities admitted for dematerialization at the depositories.

Depository: The organization responsible to maintain investor's securities in the electronic form is called the depository. In other words, a depository can therefore be conceived of as a "Bank" for securities. In India there are two such organizations viz. NSDL and CDSL. The depository concept is similar to the Banking system with the exception that banks handle funds whereas a depository handles securities of the investors. An investor wishing to utilize the services offered by a depository has to open an account with the depository through Depository Participant.

Depository Participant:
The market intermediary through whom the depository services can be availed by the investors is called a Depository Participant (DP). As per SEBI regulations, DP could be organizations involved in the business of providing financial services like banks, brokers, custodians and financial institutions. This system of using the existing distribution channel (mainly constituting DPs) helps the depository to reach a wide cross section of investors spread across a large geographical area at a minimum cost. The admission of the DPs involves a detailed evaluation by the depository of their capability to meet with the strict service standards and a further evaluation and approval from SEBI. Realizing the potential, all the custodians in India and a number of banks, financial institutions and major brokers have already joined as DPs to provide services in a number of cities .

Advantages of a depository services:
Trading in demat segment completely eliminates the risk of bad deliveries. In case of transfer of electronic shares, you save 0.5% in stamp duty. Avoids the cost of courier/ notarization/ the need for further follow-up with your broker for shares returned for company objection No loss of certificates in transit and saves substantial expenses involved in obtaining duplicate certificates, when the original share certificates become mutilated or misplaced.

Lower interest charges for loans taken against demat shares as compared to the interest for loan against physical shares. RBI has increased the limit of loans availed against dematerialized securities as collateral to Rs 20 lakh per borrower as against Rs 10 lakh per borrower in case of loans against physical securities. RBI has also reduced the minimum margin to 25% for loans against dematerialized securities, as against 50% for loans against physical securities. Fill up the account opening form, which is available with the DP. Sign the DP-client agreement, which defines the rights and duties of the DP and the person wishing to open the account. Receive your client account number (client ID).

This client id along with your DP id gives you a unique identification in the depository system. Fill up a dematerialization request form, which is available with your DP, Submit your share certificates along with the form; write "surrendered for demat" on the face of the certificate before submitting it for demat) Receive credit for the dematerialized shares into your account within 15 days

INTRODUCTION TO FOREX

Foreign exchange market is a global market. It is one type of financial market. It determines relative value of different currencies. The main function of foreign exchange is to assist international trade. It allows businesses to convert one currency into another currency so that they can do the business smoothly. For example, it allows an Indian business to import British goods and pay pound. So in a foreign exchange transaction, a purchaser purchases one currency by paying another currency.

Market Size and Liquidity

Liquidity and market size are the remarkable features of the foreign exchange market. As a most liquid financial market of the world; central banks, commercial banks, companies, currency speculators, governments, other financial institutions, retails investors etc. are traders of foreign exchange market. Volume of foreign exchange and related markets is continuously growing. As many countries have permitted the trading of foreign exchange derivative products, turnover of futures and options have grown rapidly in recent years. Foreign exchange trading is increasing tremendously day by day. This increase is due to a number of factors, such as, growing importance of foreign exchange as an asset class, emergence of retail investors as an important market segment and growth in electronic execution of transactions.

As foreign exchange market is an 'over the counter' market where dealers and brokers negotiate directly with one another, there is no need of central exchange or clearing house. The biggest trading centre is at London, UK.

Market Participants

Foreign exchange market is divided into some access levels. Interbank market is at the top, which is made up of the largest commercial banks and securities dealers. At next level, smaller banks which are followed by large multinational companies, investment management firms, large hedge funds, retail foreign exchange markets, pension funds, insurance companies, mutual funds and other institutional investors who play an important role in foreign exchange market. Central banks also participate in foreign exchange market to administer currencies as per their economic needs.

The interbank market caters the need of majority of commercial and speculative transactions. A significant part of foreign exchange market comes from financial activities of the companies seeking foreign exchange to pay for imported goods or services. Central banks play an important role in foreign exchange markets. They try to control money supply, inflation, interest rates etc. They can take appropriate steps to stabilize the market. Central bank of each country fixes daily monetary foreign exchange rate.

Determinants of Foreign Exchange Rates

Variety of factors contributes as determinants of foreign exchange rates. In a fixed exchange rate regime, government decides the foreign exchange rates. In general, floating exchange rates are decided by International parity conditions which include relative purchasing power, interest rate etc. Secondly, volume of tradable goods and services etc. Third, foreign currency is considered as an important asset class so its prices are influenced by the willingness of people to hold the asset, which depends on their expectations on future worth of the asset. Currency price is result of demand and supply of a particular currency.

Other contributors are as follows:

1) Economic factors: Economic factors include economic policy formulated by government as well as central banks. Economic conditions which is, generally, revealed through economic reports and other economic indicators. Economic policy comprises of fiscal policy and monetary policy. Fiscal policy is spending practice which is known as budget and through monetary policy, central bank influences the supply and cost of money, which is reflected by the interest rates. Generally, market reacts negatively if there is deficit in the budget and impact is reflected in the value of a country's currency. Trade flow is also an important reflection of economic policy, which demonstrates demand for goods or services, and shows surplus or deficit in trade flows. Trade deficit may have a negative impact on country's currency. So balance level of trade is also important. Inflation level and trend is one of the determinants of the foreign exchange rates. If there is high level of inflation then currency will lose the value. Economic growth and health reports such as GDP, employment levels, retail sales, capacity utilization, are some of the indicators of growth. In a healthy economy, value of currency will strengthen. Productivity of an economy in increasing trend should positively influence the value of currency.

2) Political conditions: Internal, regional and International political conditions may have a significant effect on currency markets. Exchange rates are influenced by stability of political conditions, political events and expectations from the new ruling party. Political instability may have negative impact on value of currency and economy.

3) Market Psychology: Psychology of people and traders perceptions can have effect on foreign exchange market. If investors think that if they invest in particular class of asset for a particular period then they may get better returns or for safety of investment they may think to move the asset class and this psychology can influence the exchange rate. When investors focus too much on the events occurring outside then it may impact the foreign exchange market. Further, economic reports and economic numbers can have reflection on the movement of the market, as these reports or numbers can change the mindset of people. So market psychology can have influence on the foreign exchange market.

Setting up of National Securities Depository Ltd.
National Securities Depository Limited (NSDL) was promoted by the Industrial Development Bank of India, the Unit Trust of India, the National Stock Exchange of India Ltd., and State Bank of India. NSDL is the first depository in India established in 1996. It commenced its operations on 8th November 1996. Since then it has been growing steadily.

Functions of National Securities Depository Ltd
NSDL performs the following functions through its participants:
1. It maintains investors' holdings in the electronic form.
2. It enables the surrender and withdrawal of securities to and from the depository.
3. If effects settlement of securities traded on exchanges.
4. It carries out settlements that have not been done on the stock exchanges.
5. It makes allotment in electronic form, of initial public offerings (IPO).
6. It offers facility for freezing or locking of investors' accounts.
7. It facilitates offer of securities as a mortgage for loans.

Participants of NSDL
NSDL performs its functions through its participants. The following are some of the important NSDL participants:
IIT Trust, Corporation Services, Global Trust Bank, HDFC Bank, City Bank Custodial services, Morgan Stanley Custodial Services, Reliance Share and Stock broking, Janata Sahakari Bank, Industrial Development Bank of India, State Bank of India, Standard Chartered National Securities Clearing Corporation, Deutsche Bank.

Securities are financial assets that can be traded, i.e., they can be bought or sold in the financial market. They are financial instruments and include equity, fixed income instruments, equity warrants, common stocks, etc. They can be of 2 types – debt and equity. Debt instruments such as bank notes, bonds, debentures, etc. are like borrowed money and hence have to be repaid. Stocks and shares provide the buyers with partial ownership of the company.

Central Depositories in India

There are two central depositories in India –
- National Security Depository Limited (NSDL) and
- Central Depository Services Limited (CDSL)

NSDL is the first & largest depository in India established on November 8, 1996 which is basically formed for the purpose of handling the securities held in dematerialized form in the Indian capital market. NSDL opens 3602 accounts on an average each day.
NSDL is promoted by Industrial Development Bank of India (IDBI), Unit Trust of India (UTI), and National Stock Exchange (NSE). The principal shareholders of NSDL are as follows –
- Axis Bank Limited
- Citibank
- Deutsche Bank

- HSBC
- State Bank of India (SBI)
- HDFC Bank
- Standard Chartered Bank
- Dena Bank
- Canara Bank
- Oriental Bank of Commerce

Benefits from National Securities Depository Limited (NSDL)

NSDL was created to address issues arising because of ownership of securities held in physical form and its transfer. Some of the benefits of the subscription from the organisation are as follows:

1. No bad deliveries: In case of paper based transaction, the buyer did not have the facility of examining quality of asset before buying it, hence there was a risk involved. The risk has been eliminated by NSDL as securities are held in dematerialized form and hence there are no chances of bad deliveries.
2. Elimination of risks related to physical certificates: – There is a lot of risk involved with physical certificates such as risk of theft, damage due to wear and tear, mutilation, destruction, etc. In depository system, since these certificates are now held in demat form, there is no such risk involved. It also saves the cost incurred for issuing duplicate certificates.
3. Stamp duty: Stamp duty was essential in the traditional method, now there is no need of paying stamp duty in case securities are transferred through depositories. This rule is also applicable in case of transfer of equity shares, debt instruments and mutual funds.
4. Immediate transfer and registration of securities: In depository system, once the security has been credited to the investor account he becomes the owner of that security legally. This is unlike physical system, where he/she was required to send them to company registrar for changing the ownership which used to take a lot of time. It also exposed the investor to the risk of them being lost in transit and opportunity cost in case there is a delay in transfer.
5. Faster settlement and more liquidity: In case of NSDL, settlement is done on 2nd working day from the trade day, i.e. T+2 rolling settlement. This enables faster turnover of transaction and the liquidity with investor improves.
6. Faster disbursal of non-cash corporate benefits: NSDL facilitates direct credit of corporate benefits in non-monetary forms such as bonus shares, right shares, etc. to the account of the investor. It offers the facility of quick and safe transfer of securities, thus the risk of certificates being lost in transit is eliminated.
7. Reduction in brokerage: Transfer of securities through depositories helps in reducing the back office paper work, efforts required at the end of brokers and risk faced by them being an introducer. As a result, the brokerage charged by brokers is also reduced. It is beneficial to both investors as well as brokers, thus this is a win–win situation for both.
8. Reduction in handling huge paper work: Online transaction of securities leads to reduction in paper work as everything is available online and at a click of few buttons. This doesn't require maintaining a number of trail documents for the transaction.
9. Status Reports: Periodic statement of accounts containing the details of transactions executed and status of holding are provided to the investors; thus facilitating better controls.

10. Ease in change of investor details: In traditional system, if there was any change in the details of the investor such as communication address, the investor had to go through the cumbersome process of getting it changed in every company in which he has invested. This process has been simplified as now the investor needs to inform his Depository Participants (DPs) about the change and submit relevant documents. The data is updated everywhere immediately and there is no need to inform every company separately.
11. Simplified process of transmission: The transmission of shares held in demat form can be done by simply providing required documents to DPs and transmission is reflected in the database of all the companies wherein the investor is listed as a registered owner of securities. Thus, eliminating the traditional practice in which the nominee or joint holder had to individually communicate to all the companies in which he holds shares.
12. Simplified process for sale of securities held on behalf of minor: The guardian who has been designated as being responsible for minor is not required to take prior approval of court for selling the securities held in demat form purchased on behalf of the minor.

Safety Measures Taken by NSDL

Since huge amount of money is involved in execution of transactions at NSDL, it is important to take necessary steps or measures to ensure safety. Various safety measures are carried in depository system for investors holding such as:

1. Selection criteria decided by SEBI for DP: SEBI, ensures that only credible entities are selected as depository participants
2. Recording of transactions at central NSDL server: Every transaction executed through NSDL is duly recorded on its central server and is also reflected in the database maintained by business partners.
3. Periodic Statement: DPs are required to provide periodic account statements to investors for better controlling.
4. Periodic checking/inspection: Depository participants and Registrar & Transfer (R&T) Agents are subject to regular audits by NSDL.
5. Random counter checks: Random checks are done by NSDL by forwarding statement to random list of investors so that they can match the statement issued by DP & find out the discrepancy, if any.
6. Control on account entries: Only after the verified instruction of client, DPs are allowed to execute any debit or credit entries in the concerned account.
7. Protection of data: Data exchange between NSDL & its business partners are protected by encryption in accordance with latest technologies.
8. Freeze Facility: A Depository account holder can avail freeze options for freezing the securities lying in the account as long as the account holder wants. An account holder can activate any of the following freeze options –
    - Debits only
    - Debits & Credits
    - Freezing just an individual ISIN in the account
    - Freezing a specified number of securities that exist as part of an ISIN in an account

9. Investor Grievance: All the concerns and grievances of investors have to be resolved by the concerned business partner. If the same cannot be resolved by the business partner, then one can directly approach to NSDL.
10. Insurance Cover by NSDL: To protect the investors from the loss due to omissions, errors, negligence of DPs, etc., NSDL covers and compensates for any such loss.
11. Computer & Communication Infrastructure: It is ensured that the computer hardware and software used by NSDL & its business partner are high end and in conformation to the industry standards.
12. Certification in Depository Operations: NSDL has introduced a certificate programme (NCFM certification) in depository operations for DPs. This course must be cleared by at least 1 individual from each DP. This is done so as to ensure that every branch of DP has at least one individual who is an expert when it comes to depository systems and can explain the same to the local investors as and when required.
13. Disaster Back-Up: NSDL maintains a disaster back-up site to ensure 24×7 availability of the data even after natural or man-made disaster. This site is identical to the mainframe computer and operates when main computer becomes in-operational.
14. Periodic Review: Entire hardware, software and communication network is periodically reviewed to ensure its effectiveness and security.

Services Offered by NSDL

The services offered by NSDL can be grouped under 3 categories:

- Basic Services: As per the provisions of the Depositories Act, NSDL provides various services to investors, brokers, banks and other security issuers participating in the Indian financial market. Any investor, broker or intermediary who wants to avail services of NSDL, is required to open a depository account with DPs.

Depository account can be of 3 types:

- Beneficiary account,
- Clearing member account and
- Intermediary account.

Services provided on the above-mentioned accounts are:

1. Dematerialization: It is a process by which an investor can convert physical certificates into electronic balances.
    - For dematerialization, the investor needs to deface the certificates and surrender them to the Depository Participant.
    - DP intimates NSDL and sends the certificates to the concerned Issuer/ R&T agent.
    - If the Issuer/ R&T agent is satisfied with the certificates, confirmation request is communicated to NSDL.
    - Once the confirmation is received, securities are credited in the depository account of investor by NSDL.
2. Rematerialzation: It is the process through which an investor can convert his securities held in electronic form into physical certificates. For rematerialzation,
    - The investor is required to submit a rematerialzation request to the DP who has the investor’s account.

- The DP blocks the holding of the investor by entering the rematerialzation request in the system.
- The securities are blocked only to the extent to which rematerialzation request is received.
- The DP sends the request to NSDL along with request form to Issuer/ R&T agent.
- On receiving the request form, the Issuer/ R&T agent prints the certificates and dispatches them to the client.
- NSDL is also intimated about the acceptance of the request.
- Thereafter, the client's blocked balances are debited.

3. Market Transfer: The investor can buy or sell the securities held by them in the dematerialized form.
4. Off-Market Transfer: Trades which are not settled through the Clearing Corporation/ Clearing House of an exchange are classified as "Off-Market Trades". Delivery of securities to or from sub brokers and delivery for trade-for-trade transactions are some of the examples of off-market trades.
5. Inter-depository transfer: Transfer of securities from an account in one depository to an account in another depository is known as inter-depository transfer.
6. Transmission: Transmission is devolution of title to shares other than by transfer i.e. devolution by death, succession, inheritance, bankruptcy, marriage, etc. This is operational by law.
7. Corporate Actions: Corporate actions are benefits given by companies to the investors. These benefits can be monetary such as dividend, interest, etc. or non-monetary such as bonus, rights, etc.

- **Value added Services:** NSDL provides various other services like hypothecation of securities, pledge, automatic delivery of securities to clearing corporations, distribution of various cash and non-cash benefits, stock lending, demat of NSC/KVP, demat of warehouse receipts, etc. Some of the services provided are as under:

1. Pledge or Hypothecation of securities: For availing loan or credit facility, securities held in a depository account can be pledged or hypothecated. Both the borrower (pledger) and the lender (pledgee) should have account in NSDL depository for pledging securities.
2. Automatic Delivery out Instructions: This facilitates Clearing Corporation to execute delivery-out instructions for moving securities from CM Pool Account to CM Delivery Account automatically based on the net delivery obligations of its Clearing Members. The Clearing Corporation can generate Auto DOs on behalf of only those Clearing Members who have authorized it in this regard.
3. Dividend Distribution: Currently, NSDL only facilitates distribution of corporate cash benefits such as dividends to shareholders.
    - Details of all beneficial owners of the security as on the record date of the concerned company are provided by NSDL to the company or its registrar
    - This data is shared with the transfer agent (R & T agent)
    - Thereafter, the company's R & T agent dispatches dividend entitlements to the beneficial owners
    - Beneficial owners are eligible in the same manner as shareholders holding physical certificates.

4. Lending and borrowing: The transactions which involve lending and borrowing of securities can be executed through approved intermediaries duly registered under the Securities Lending Scheme, 1997 with SEBI.
    - An intermediary can deal in the depository system only through a special account (known as Intermediary Account) opened with a DP.
    - An intermediary account may be opened with the DP only after the intermediary has obtained SEBI approval and registered itself with SEBI under the Securities Lending Scheme.
    - The intermediary must also obtain the approval from NSDL.
5. Public Issue: Investors have an option to seek allotment of public issues in electronic form.
    - NSDL depository system provides facility for allotment of securities directly in to the depository account of the investors in the demat form.
    - As per SEBI guidelines, trades in shares issued through public shall be settled only in demat form.
    - It is advisable that investors seek allotment in demat form.
6. SMS Alert: NSDL offers SMS Alerts facility for demat account holders wherein they can receive alerts directly from NSDL for various transactions such as all debit transfers, failed instructions, overdue instructions, etc. No charge is levied by NSDL for providing this facility to investors.

- NSDL CAS (Consolidate Account Statement): It is a single statement of all investments held in single and joint names in the security market. This facility helps subscribers to electronically access their financial assets as a part of single account. The NSDL consolidated account statement includes details of multiple financial instruments such as mutual funds, investments in equity shares, debentures, government securities held in demat form, bonds, money market instruments such as treasury bills, etc.

The statement is provided only to the primary or sole account holder of the investment account whether held in single or joint name. NSDL CAS is a popular tool as it facilitates the investor to keep a track of his investment portfolio in a simple and reliable way thus ensuring that informed decisions are taken.

NSDL e-Services

As a part of value added services, NSDL also provides various online services known as e-services. These services facilitate faster and reliable execution of transaction. The various e-services provided by NSDL are:

1. SPEED-e:
    - This service was launched in September 2001.
    - It enables the investors to directly upload delivery instruction on SPEED-e website thus reducing the turnaround time.
    - This is available only to those participants who have subscribed for this service.
    - The subscribers are provided with access rights through passwords or smart card or e-token.
2. IDeAS (Internet-based Demat Account Statement): This service was launched in January 2004. It facilitates viewing balances and transactions executed in the demat account online.
3. STEADY (Securities Trading Information Easy Access and Delivery):
    - This service is basically launched for contract notes.

- Through this service, brokers can electronically deliver/submit contract notes to custodians/ fund managers
- Brokers have to transmit digitally signed trade information with encryption.
- It also allows the recipient to enhance or modify contract notes.

4. Depository Account Validation (DAN):-In this service, subscribers can validate/authenticate identities such as client ID, DP ID, PAN and other basic details provided by the investor through online platform.
5. SPICE (Submission of Power of attorney based Instructions for Clients Electronically):
   - In this, Clearing Members can submit auto pay-in instructions to participants (where Clients maintain demat accounts) on SPEED-e facility to debit from the demat accounts of the Clients and credit their Clearing Member (CM) Pool Accounts.
   - Clearing Members are customers who have given Power of Attorney (POA) in favour of the Clearing Member
6. SIMPLE (Submission of Instruction through Mobile Phone Login Easily):
   - This service is for those clients who avail SPEED-e services and use password to login.
   - It facilitates the clients to issue transfer instructions using the mobile phones registered with NSDL.
   - To execute a transaction, the subscriber is required to login to the SPEED-e website using any phone which has GPRS facility.

Business Partners of NSDL

NSDL carries out its activities through various functionaries called "Business Partners" such as:

- Depository Participants (DPs),
- Issuing companies
- Registrars and Share Transfer Agents,
- Clearing corporations/Houses of the Stock Exchanges
- Investor
- Broker

These entities should get integrated into NSDL's depository system to provide key services to the clearing members and investors. The investor can obtain depository services through a depository participant of NSDL. It is similar to opening an account in bank. As a person opens a bank account to avail the services of a bank, an investor opens a depository account with a depository participant in order to avail depository facilities. Some salient features of NSDL's business partners are:

- A clearing member is allowed to open a special account with the depository system for settling trades carried through stock exchanges.
- The clearing account helps the clearing member in receiving securities from clients for the purpose of delivery to the Clearing House/Corporation as pay-in
- This account allows the clearing member to distribute the pay-out to clients received from the Clearing House/Clearing Corporation.
- The clearing corporations/houses of stock exchanges also have to be electronically linked to the depository
- Once linked, these corporations can electronically receive securities delivered by clearing members towards pay-in

- Clearing corporations can give out securities to clearing members towards pay-out.
- An issuer can allow its shareholders to dematerialize by signing an agreement with NSDL.
- After the issuer signs the agreement, an electronic link is established between NSDL, issuer or its R & T Agent.
- NSDL is electronically linked to each of these business partners.
- Specific processes are defined to make an application to NSDL for becoming a business partner.

The business partners of NSDL are as follows:

Depository Participants (DP)

NSDL provides services to the investors through Depository Participants. Bank, financial institution, custodian, broker or any entity eligible as per SEBI regulations can be appointed as a DP. Using the existing distribution channel helps NSDL reach large number of investors spread across wide geographical area. Investors are required to open a depository account with a DP to avail depository facilities. Appointment of DPs is a 2 step process:

- Evaluation and confirmation by SEBI
- Evaluation and approval by NSDL

Issuers

To become an issuer in NSDL, the entity must be able to offer dematerialization facilities to the shareholders. Security issuers, who have entered into an agreement with NSDL can dematerialize the security issued in NSDL depository. Issuers have to verify the certificates and maintain electronic connectivity. Following is the process for appointment of the issuer:

- An issuer needs to submit the prescribed documents including the letter of intent, audited financials for last 2 years, etc. to NSDL
- NSDL forwards blank Tripartite Agreement to R & T agent.
- The R&T Agent and the issuer signs the agreement
- This agreement is sent back to the NSDL

Registrar and Transfer (R&T) Agent

In NSDL depository system, the issuer can create and extinguish securities held in the demat form. Securities in demat can be created and extinguished in 2 ways. The ways in which securities can be created are:

- By converting the physical securities into demat form, i.e. dematerialization
- The issuer releases instructions to NSDL to credit eligible beneficial owners with securities as per their entitlements

The two ways in which securities can be extinguished are:

- Rematerialisation, i.e. converting demat form securities into physical certificate form
- The issuer releases instructions to NSDL to debit eligible beneficial owners with securities as per their entitlements

To effect these actions, the issuer may utilize the computer facility (named DPM-SHR) that is built in-house or borrowed from the said R&T Agent. Thus, the R&T Agent lends the required computer facility to confirm and execute these activities. Following is the process for appointment of R&T agent:

- Submit an introduction letter to NSDL
- Procurement and installation of required hardware and software
- Submission of the fee to procure DPM-SHR software
- Provision of training to the personnel who shall be managing the operations and equipment

- Pilot testing has to be done to check the working and response of the software system configured
- When NSDL activates the respective business partner as a share registrar, R&T Agent status is confirmed

Clearing Corporation/House

Any stock exchange that desires to facilitate settlement in demat shares should have a clearing corporation/house with a fully operational settlement guarantee mechanism. The settlement guarantee mechanism should be approved by SEBI. A clearing house is a mediator between the buyers and the sellers of financial instruments. It is responsible for settling trading accounts, clearing trades, collecting and maintaining margin money, regulating delivery, and reporting trading data.

- The corporation needs to have an operational structure that guarantees settlement
- The corporation also ensures that the payment against delivery is done flawlessly and in a timely manner
- NSDL has to be satisfied that the Clearing Corporation/House possesses the operational expertise to provide services related to the settlement of transactions with respect to securities that are in demat form
- The Clearing Corporation/House must have possession of necessary hardware and software systems that are crucial for interaction with the Depository without lags/timeouts.
- A clearing house has to ensure the redressal of grievances of clients and participants with respect to its operations in relation to the depository
- The procedure for joining NSDL, systems specification and investments and expenses to be incurred by a clearing corporation/house is same as that of Depository Participant**.**

Investor

An investor is a person or entity that invests in the financial instruments. An investor has to just open a beneficiary account with the DP along with the required documents.

Broker

Brokers are an important link between investors and the associated Clearing Corporation/House. They must have a clearing account with any DP. Such an account can be utilized only for the purpose of receiving and transferring the shares from and to the concerned Clearing Corporation/House. The broker does not have any ownership rights on the shares that move to and fro his account.

Clearing Member Accounts

The clearing member account has three parts:

- Pool Account: Shares are received from selling clients in the pool account. Transfer to buying clients is also done from the pool account.
- Delivery Account: Shares received from selling clients are moved from the pool account to the clearing corporation/house through the delivery account.
- Receipt Account: Shares are received in the pool account from the clearing corporation/house through the receipt account.

Account opening by NRI/PIO

- A Non Resident Indian (NRI) or a Person of Indian Origin (PIO) can open a demat account with any depository participant of NSDL.

- The NRI/PIO needs to mention the type of account, i.e. resident or non-resident and sub-type of account, i.e. repatriable or non-repatriable in the account opening form.
- No permission is required from RBI to open a demat account by NRI/PIO.
- Credits and debits from demat account may require general or specific permissions as the case may be, from designated authorized dealers.
- In case a person becomes NRI after opening of the account, he can continue to hold the securities which he/she had purchased as a resident Indian, even after he/she has become a non-resident Indian, on a non-repatriable basis.
- If an NRI coverts his/her status to a resident after opening of account, he should inform the designated authorised dealer and the DP with whom the demat account has been opened.
- Once the information has been conveyed, a new demat account with the resident status will be opened
- Securities are transferred from the NRI demat account to resident account and thereafter the NRI demat account is closed.
- An investor may nominate one or more persons who shall be deemed eligible to claim the proceeds of the account, in case of death of the investor.
- Nomination can also be done by joint holders.
- In case of death of any of the joint holder(s), securities will be transmitted to the surviving holder(s).
- Only in the case of death of all the joint holders, securities will be transmitted to the nominee.
- Nominee can be appointed by filling and submitting nomination form either at the time of opening the account or at a later stage.
- The nomination form requires details of the account, details and signature of nominee, and signature of 2 witnesses.
- Only one nomination can be made for one depository account.
- Different nominations cannot be made for different securities.
- The facility of nomination is available only to individual account holders for both individual and joint accounts.
- A minor cannot nominate directly or indirectly through his guardian.
- Nomination cannot be done by non-individuals such as trusts, partnership firms, POA holders, etc.
- Only individuals can be appointed as nominee, and non-individuals such as trusts, etc. cannot be appointed as nominees.
- Minors can be appointed as a nominee.
- The guardian's signature is required on behalf of the minor nominee. The name and photograph of the nominee and address and photograph of the guardian must be submitted to the DP.
- The account holder can change the nomination anytime by simply filling up the nomination form once again and submitting it to the DP.
- An account held with another depository can be transferred to NSDL on submission of necessary documents. Hence, inter depository transfers are permitted by NSDL.

Charges

Services provided to investors and clearing members are through DPs. NSDL charges fees from DPs for the services provided and in turn DPs charges fees from their clients.

Fee Payable by Depository Participants

1. Entry Fees: ₹ 25,000 (Non-refundable)
2. Settlement Fees: ₹ 4.50 Per Debit Instruction
3. Pledge Fees: ₹ 25 per instruction for creation of pledge/hypothecation
4. Custody Fees: NIL
5. Fee for dematerialisation of securities: NIL
6. Fee for rematerialisation of securities: ₹ 10/hundred securities or part thereof, or flat fee of ₹ 10 per certificate (whichever is higher). No rematerialisation fee is charged for government securities.
7. Minimum Fees: ₹ 1.00 Lakhs (if fees charged is less than the minimum fees than difference will be charge thereof)
8. Security Deposit: Each participant have to pay an interest free refundable security deposit of ₹ 10 Lakhs. Clearing Corporation/House of a Stock Exchange will be exempt from payment of security deposit.

POSSIBLE QUESTIONS

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

PART –B

1. Write short notes on Settlement and Rolling settlement Process
2. What are various categories of merchant banking?
3. Explain the functions of Financial intermediaries.
4. What is the meaning of Depository & Depository Participant?

PART –C

1. Draw up the classification of Merchant Bankers as laid down by SEBI.
2. Narrate the role of NSDL& CDSL.
3. Bring out in detail the various functions of stock exchange
4. Enumerate the interlink between money market and capital market.
5. Evaluate various procedural aspects to be followed in Forex..
6. Discuss the various characteristics of financial markets.
7. Discuss the process of dematerialisation services.

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 17th and 18th 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- OBJECTIVES OF FINANCIAL SERVICES

SYLLABUS

Unit II
Objectives of financial services – type of financial services (fund based and fee based); Capital market services and money market Services; Intermediaries- banking Financial Corporation; Non-banking financial Corporations; Insurance corporations; Financial Service Sector Problems and Reforms; Growth of financial services in India

OBJECTIVES OF FINANCIAL SERVICES

Financial institutions, such as banks, credit unions, stockbrokers, finance and insurance companies, often have a business plan with a set list of goals and objectives. These objectives are a set of standards or goals that the institution as a whole and each employee will work toward on a daily basis. Objectives can be external and benefit the customers and clients, but also can have external benefits and create a brand for the financial institution.

Quicker Customer Service

Financial institutions may have customers coming in to get services or use self-service options to speed up the service process. Since customers and clients are an important asset for financial institutions, an objective is to provide the best customer service to keep clients satisfied and happy. Banking institutions, for instance, may want to improve the customer service procedures within the bank when people come in to pay bills or withdraw money. Credit unions could have the same objective, as members are given reasonable credit rates and the unions need the members to stay active and afloat.

Help People Invest

Some financial institutions, such as banks and stockbrokers, offer people help in investing to increase income and worth. If the client has little to no experience in financial investments, the stockbroker or banking manager should provide the knowledge and expertise to help the client invest wisely. An objective can include teaching and helping clients understand the world of investing and teach them tools to keep track of their own investments.

Savings Plans

Many financial institutions manage people's personal money. Since fees, investments, insurance and other services may cost the customer money, a financial institution may have an objective to provide services and savings plans that will save the customer money. This can include combining banking and insurance services for one financial institution rather than having several service providers. It also can mean changing insurance plans, for instance.

Insurance Premiums and Plans

Insurance companies and larger banking branches may offer clients insurance plans and premiums to protect clients. This can include credit card insurance, loan limit insurance, car insurance, travel and home insurance, and insurance against burglary and home invasion. Since the needs of each client differ, the financial institution may have an objective to provide insurance plans that are tailored for each client. This is not only to keep current clients satisfied but also in hopes of attracting new customers.

Eight types of fee based activities in India.

The types are: 1. Issue Management 2. Portfolio Management 3. Loan/Lease Syndication 4. Corporate Counselling 5. Arranging Foreign Collaboration 6. Advising on Acquision or Mergers 7. Project Counselling 8. Advising on Capital Restricting.

Fee Based Activity: Type # 1. Issue Management:

Like ordinary issue, the process of issue management is same. It is, however, the duty of the Non-Banking Financial Company to supply a complete set of services and must try to improve and develop the process of marking the issues by which the net work of the promoters will be extended.

It is needless to say that the institutions who will take the responsibility to supply the services, must be able to improve the network of the brokers which ultimately brings a success relating to the issue.

If the issues are not subscribed the same may be closed on the earliest closing date. In order to overcome this difficulty, these companies join with others and form a club taking 5 to 10 merchant bankers (those who are authorised) who must take a minimum corpus of funds.

Now, if the issue goes in the hands of the club, there will be, no doubt, hesitation on the part of anyone regarding the investment in the issue having a public support and as such, the issue closes at the earliest closing date which relieves the promoters regarding the issue.

As a result of the above, the merchant bankers and the Non-Banking Financial Companies (NBFCs) will earn a reputation in the market by which they can promote many businesses. NBFC, to some extent will capture and curtail the business that flows to the institutions belonging to the state level.

Once the technique becomes successful the club can be extended to 10 or more i.e., instead of acting as competitors among themselves, the sharing of income in the form of fees as a result of the close co-ordination becomes more profitable and rewarding as well.

In future, they can easily form a group and the regional guilds in order to supply the services more effectively and efficiently as well which will be a blessing to the business world.

Fee Based Activity: Type # 2. Portfolio Management:

Portfolio management implies the investment of funds taken from numbers/clients in various securities and an adequate return should be given to them. In other words, it is a scheme by which the portfolio manager raise funds from his clients/members with a commitment in order to operate the securities market together with the information, in well explained terms relating to the composition of portfolio, annual return, appropriation of capital, the extent of risk etc.

The manager must be authorised by the Securities and Exchange Board of India positively. Before certifying a manager as authorised, the SEBI will enquire about the infrastructure and truck record of the firm For this purpose, a minimum amount of net worth/shareholders' fund has been fixed at Rs. 50 lakhs.

It is the duty of the portfolio manager to maintain the funds which belong to his clients/ members with the schedule bank in a separate account, which will be invested according to the terms specified. The manager is, however, entitled to a fixed fee and not a variable one depending upon the returns to the clients/members accordingly.

It is also the duty of the NBFCs to see that guidelines that are laid down by the RBI relating to the restrictions on announcement of guaranteed returns, are followed properly in addition to the other guidelines.

The NBFCs may adopt the approach of investing in the debentures of good companies and a particular proportion should be invested in shares through the primary market route and the balance amount of the fund, should be invested in the secondary market.

Fee Based Activity: Type # 3. Loan/Lease Syndication:

The practising Chartered Accountants who supply the liaison services to the clients where they are in need of funds whether for the purpose of working capital or for term loan purposes.

At present, it has been found that the Chartered Accountant firms are keen interested to keep in touch with the large group of companies and are trying to improve their contact with others with the help of such giant clients who are doing quite successful business.

When a company finds it difficult to procure funds who has some problems, weakness and is not able to get various services, these firms appear in the picture and act as an intermediary between the institution and the company as well In this particular case, NBFC, can play a very prominent role for procuring funds and assist them in various ways, can supply the necessary services for those clients.

They can act as a broker and their fees must be comparable with the fees charged by the Chattered Accountant firms. In order to serve these services, NBCFs should have a direct contact with the high officials of the banks and various financial institutions simply in order to collect the necessary information.

In fact, when the company will be able to know the rules, regulations, procedures of the financial institutions and-its proper operation and will grow its contact, its requirements will be fulfilled very soon.

About leasing, however, it becomes necessary to collect a list of institutions/companies who are engaged with leasing business along with their respective quotation which will assist the company to evaluate the offers received by it in near future.

It is to be noted that many companies are engaged with leasing business usually in the 2nd half of the year and deal in 100% depreciable items which is, rather, considered as their primary objectives.

Thus, any information about them can easily be collected by the company and it can make necessary arrangement for the clients particularly who can pay the rent as soon as it becomes due. In this way NBFCs, can help a lot which may be considered as their moral duty which will prove worth in future. For this services the NBFCs can charge a fee which must not exceed 5% of the funds being a fee based activity.

Fee Based Activity: Type # 4. Corporate Counselling:
The corporate counselling is an another attractive fee based service. At the time of diversification, expansion and development, a medium size company needs the service of an expert relating to the above for which they seek the advice from various institutions. The institutions also come forward to assist them as soon as they receive the formal request from such firms.

Now, in this context the role of NBFCs is very important. They can perform various functions relating to the generation of funds by developing the existing systems and pointing out the weak areas of the companies.

Usually, the company receives the services either from an individual who is an expert in this line or from the firm of Chartered Accountants who possess the latest data relating to financial information although their area of services is to some extent limited.

In other words, they can supply the information and necessary data which they have collected from their clients in the past and can apply only the same and particularly, beyond this level, they are helpless. For example, if a company wants to invest a greater amount of funds in a capital project, which requires the services of capital budgeting and as such, can eliminate the various projects which are less profitable.

This sort of information is readily available with them. So, a company who is going to take an extension programme, it can have the readymade information relating to the various attractive projects. On the basis of such data and necessary information, it can suggest a few concrete propositions which may be proved worth.

Moreover, these brokers and brokerage firms under the NBFCs group possess the old data and information that they collect from the Government publication which may not have any relevance to the present day economic condition and changing circumstance of the society.

However, the corporate counselling requires every aspect of the project in details. That is why, a company which is specialised on a particular line, e.g., product selection, must be able to supply the necessary related information about the utility of the product, its various cost structure, market competition etc.

In short, it is practically impossible for a single company to maintain all the data relating to various kinds of products.They should, of course, have a close contact with other NBFCs who are related in that particular line. In short, a company should not change its position. Needless to mention here that the various institutions are not able to supply this sort of services to the clients concerned.

Thus, NBFCs should enquire about it very carefully and at least one or two areas of specialisation must be selected by it and to maintain a close contact with other for other necessary information and data which are also very important in order to serve them better.

Fee Based Activity: Type # 5. Arranging the Foreign Collaboration:

It is one of the most significant tasks of the project management and the companies to arrange the foreign collaboration particularly who wants to specialise in the above area and should consider the matter carefully.

As a result of the liberalisation relating to industry and capital market by the Government of India, the companies are employing their resources which they acquire by issuing shares via primary capital route and as such, are interested for good projects relating to either export oriented project or import substitution projects.

Needless to mention here that the companies need technical know-how for both the types of project from the suppliers who supply overseas technology. NBFCs should collect the necessary information about it.

It may also be mentioned here that it is impossible for companies to maintain the data for all kinds of industries, rather they should have specialized either one or two types of industries in the beginning and if possible gradually to maintain the data relating to suppliers of foreign technology.

However, NBFC must contain such data and keep the information relating to the latest technology from them who have already acquired earlier along with the result. Details of the similar technology, if any, may be taken into consideration along with their particulars.

Moreover, necessary information relating to the fees, mode of settlement and remittance of such fees or royalties, together with the various rules and regulations relating to them, should be collected.

Indian Policy towards Foreign Collaboration:

Regarding foreign collaboration, the Government of India, permits in certain areas in the field of high priority and the areas where the import of foreign technology is absolutely required. In other areas, import of technology may be considered on merit if substantial exports are guaranteed over a period of 5 to 10 years.

In 1985, however, a big spurt took place in foreign collaboration between India and other countries, U.S.A. at the top. According to Indian Investment Centre, 1024 collab-oration agreement was signed between Indian and foreign companies during that year and the total investments involved in these collaboration worked out to Rs. 125.36 crores.

The collaboration which were approved in 1985 contained a wide range of industries, viz., electrical equipment (205), industrial machinery (152), transportation (101), chemicals (69), metallurgical industries (53), industrial instrument (52), telecommunication (36), machine tools (32), ceramics (27), consultancy (23), fuels commercial office and house equipment (20 each), leather goods pickers (19), prime movers (15), boilers and steam generating plants (13) and earth moving machinery (II).

However, the proposals of NRI's which were approved during that year were 52, out of which 24 came from USA, 5 from FRG, 2 each from France, Italy, Japan, South Korea, Sweden and U. K., 1 each from Canada, Finland, Cyprus, Ireland, Kuwait, the Netherlands, Sri Lanka, Singapore, Taiwan and Switzerland.

Fee Based Activity: Type # 6. Advising on Acquisition and Mergers:
NBFC should pay the proper attention in this field. In order to consolidate the firm and to form a new one or to enjoy the benefits of economies of large scale, many companies are interested to amalgamate. The matter is very clear and simple if the management of both the companies is ready to do so.

To have these objectives, sometimes the promoters misuse their powers over the various companies. For this purpose, the Government has laid down certain guidelines prescribing the maximum limit of holding by the NRJs in the Indian companies recently.

Now these figures are to be informed to the RBI. As a result, no company can remit the dividend to NRIs before taking the approval from the RBI for which RBI exercise a direct control over the outflow of foreign exchange. It is needless to say that these areas, viz., acquisition and mergers need collective knowledge of pro-fessionals including legal practitioners, Chartered Accountants and other technical people in the line.

Fee Based Activity: Type # 7. Project Counselling:
It is practically coming from the concept of corporate counselling and under the circumstances, the concerned company employs engineers and MB As and other technical persons who are experts in the area of project management.

If the client desires to invest his resources on long term basis to any project and is ready to invest such funds accordingly as per guidelines presented by the consultant company, the same task can be performed by the NBFC accordingly. Better result can be achieved if these companies form an informal association or a guild.

However, the project counselling will include the following:

1. Identification of raw material suppliers.

2. Selection of site of the project.

3. Identification of major plant and machinery suppliers.

4. Helping the company in funds resourcing and preparing the project report, which is to be submitted to the institution in connection with the sanction of the loan.

5. Advising the company an alternate means of financing.

6. Advising and arranging some portion of promoters, contribution from financial institutions.

7. Advising the clients about availability of foreign collaboration.

8. Advising the companies about the sales strategy i.e., whether to develop its own staff or to develop dealer's network etc.

9. Advising the client on the sales strategy, trade discounts, cash discounts etc.

From the above, it reveals that project counselling includes a lot of financial services starting from procurement and arrangement of funds and its application thereof. Since the project counselling is a specialised task, it is better to be specified in one particular unit of industry and to supply the service against a reasonable fee which should have been low proportionately at the beginning in comparison with other units.

The primary criterion should be to supply the quality service at first. For this purpose, collecting and maintaining data relating to the same industry from various sources should be presented.

When the company will gather some experience in this line and is able to supply the necessary particulars confidently and is also familiar with the mechanism of project management in a particular unit, it can go for another industry as well.

It can also be stated here that once the particular task is undertaken some other allied services may also be provided, and naturally for the purpose of executing a particular project, appointing unskilled and junior staff is of no use.

Because, there should be a direct relationship between the institution relating to procure funds, preparing cash budgets and to maintain the different books of account. Unfortunately, a small portion of the said task may be handed over to Non-Banking Financial Company. So, it can be stated that corporate counselling and project counselling should be taken up by the NBFC or a very small scale and in simple form.

Fee Based Activity: Type # 8. Advising on Capital Restructuring:

For the purpose of fresh issue, the companies have to present and prepare their Balance Sheet in a healthy form but not with the product of window dressing which produces an effective use and application of financial management as a whole. It is not an easy task. It requires a lot a practical exercise and experience. Sometimes, professional advice may also be required.

Needless to mention here that NBFC can supply the necessary service for the purpose on various matters by giving their valued advices and instructions, e.g., capital structuring/restricting, so that the financial health of the enterprise through the Balance Sheet would be looked better. Since, it is a fee based service it will, no doubt, earn a lucrative amount.

The NBFC will be in a better position relating to these areas if they fix their reasonable fees in comparison with the Chartered Accountant or any other professional organisation to whom the companies seek valuable advice.

Major areas of fund based activities. The areas are: 1. Leasing 2. Hire-Purchase 3. Bill Discounting 4. Factoring 5. Venture Capital.

Fund Based Activity: Area # 1. Leasing:

Leasing is the most significant development as a method of procuring assets which has taken place in the field of finance during the past five decades although it was on real estate leasing at first During the past several years, various firms are granting lease almost all types of fixed assets.

Although at present, it is not known to us the amount of leased equipment in use, even then it may be safely concluded that lease financing is one of the major sources of external financing which are being used by many industries.

It is not possible to comment the reasons for its popularity, i.e., whether it is the result of financial controller's desire to conserve funds or, it arises from the increased effort of the so called leasing companies.

There are two principle techniques of leasing, viz.:

(i) Leasing rather than purchasing the assets; and

(ii) Sale and Lease Back.

However, in the case of former, a firm makes a contract to rent an asset from another firm.

The contract contains usually the following terms and conditions:

(i) A basic term during which the lease cannot be cancelled;

(ii) Periodic rental payments (cost of original investment plus a return);

(iii) The cost of maintenance (e.g., taxes, insurance etc.)

(iv) An agreement that will permit the firm to continue to use the assets after the basic lease term.

Advantages of Leasing:

There are some authorities who do not accept all the advantages of lease financing.

But the following advantages are accepted by them:
(i) Permits a lease to obtain the use of property that he cannot acquire in any other way;
(ii) Provides facilities that are needed only temporarily;
(iii) Avoids the risks of obsolescence;
(iv) Relieves the user of maintenance, service and administrative problems;
(v) Provides an additional source of financing; and
(vi) Gives the lease flexibility.
The following four advantages are not accepted unanimously by the authorities. They are:
(i) Lease frees working capital;
(ii) It yields a tax savings;
(iii) It improves the lessees' apparent financial position; and
(iv) It spares management the need to review capital expenditure.
Disadvantages, of leasing:
Although leasing finance has some district edges, even it is not free from snags. They are:
(i) High cost;
(ii) Loss of residual values;
(iii) The possibility that a premium will be demanded for vital equipment unless adequate care is taken when the lease is negotiated;
(iv) Inadequate evaluation due to habitual leasing;
(v) The lack of accumulation of equity, which could have some adverse effects on future financing; and
(vi) Various facilities may be lost at the end of the lease period.
However, the validity of the above disadvantage depends on the various alternatives which should carefully be chosen while negotiating lease agreement. Because, there are several factors which directly affect the leasing finance for alternations, e.g., rate of tax, the repayment schedule, the rate of interest, the method of depreciation etc.

Sale and Lease back:
Under a Sale and Lease back arrangement, a firm sells an asset which it owns to another party who again leases it back to the firm. The asset is usually sold at a market price and the firm receives such amount in cash and also receives the economic use of assets during the lease period. Periodic lease payments are made in return and give up the title of the assets.

As such, the lessor will realise the residual value, if any, at the end of the lease period. Usually the firm sells the asset to a financial institution, Insurance companies, finance companies or institutional investors. It is to be noted that most lease-back are on a net-to-net basis which implies that the lessee pays all maintenance expenses including taxes, insurance and lease payments as well

Sometimes it may so happen that the lease arrangement allows the lessee to re-purchase the asset when the lease period is terminated. The purchase price may be determined on the basis of economic condition, e.g., at its fair market value.

Classification of Leases:

Basically, the leases can be classified into three following groups:

(a) Operating Lease:

Under the circumstances it does not impose any long-term obligation neither the lessor nor the lessee and it may be cancelled by either side after serving a stipulated notice, e.g., the rental of an office space on a 3-year lease cancellable on 30 days.

(b) Service Lease:

Under the circumstances, the lessor supplies both financing and servicing the asset during the lease period. Usually, capital assets, e.g., computers, trucks etc. are leased under this type of contract which provide maintenance or servicing of the assets

(c) Financial Lease:

Under the circumstance, the lease arrangement is considered as long- term lease on fixed assets which must not be cancelled either by the lessor or by the lessee. It is, practically, like long-term debt financing.

Characteristics of Leases:

(1) Service Leases:

Services leases are becoming popular as the modern machinery and equipment require frequent specialised maintenance and servicing.

Thus, its significant characteristic are:

(i) Cost of Maintenance is included in Lease:

According to the terms, the lessor is liable for maintaining the equipment and supplying all routine services including repairs It actually protects the lessee from correcting major break-downs for the same,

(ii) Lease may be Cancelled:

Usually, the service lease is cancelled by the lessee. For this purpose, the lessee makes some provisions for a penalty if the lease is cancelled before its expiry date although a stipulated notice is necessary for cancellation.

(iii) Equipment Machinery may not totally he Amortized:

In case of amortization, usually a firm writes it off completely during the period under consideration. In this type of lease, however, the lease payment may be insufficient to allow the lessor to recover the original cost of such asset which implies that the lease period is comparatively less than the service life of the asset.

(2) Financial Leases:

The characteristic of financial leases are noted below:

(i) Long-Term Period:

These types of leases cover a long-time period, e.g., 1 to 10 years. At this period, the firm must have to satisfy lease requirements even if the equipment becomes obsolete or of no use.

(ii) Rigid Obligation:

It imposes certain obligations. It cannot be cancelable.

(iii) Fully Amortizing:

According to the terms of agreement the lease covers the service period i.e., if the expected life of the equipment/machinery is 10 years, the firm also takes the period of lease approximately 10 years.

It is interesting to note that if asset possess an indefinite life, like Land and Building, the lease will be written as even service life may be considered as 30 years. Under the circumstance, the Land and Building is totally amortized.

(iv) Profit earned during the period of lease:

This lease gives some profit to the lessor (i.e., total lease payment is more than the total cost of the assets) during the period of lease. If the asset possesses any residual value, the entire amount will be treated as an extra profit.

Sources of Funds for Leasing. It has been highlighted above that financial institutions, insurance companies, finance companies and institutional investors supply funds for leasing. In other words, a firm who seeks funds finds various institutions for the purpose.

Some of them are:

(a) Commercial Bank

At present commercial banks are increasingly interested in lease financing. The banks make necessary arrangement to buy equipment and lease the same to a customer either directly or through a company. As the additional service is provided by the bank it attracts the customers for other financial services.

(b) Financial Service Companies:

We know that there are some commercial finance companies/leasing companies who supply the necessary funds for specialised machinery or equipment. Usually these companies take expert staffs who are acquainted with the re-sale market for such specialised equipment or machinery and terms of the lease agreement is practically developed by them.

(c) Life Insurance Companies:

The Life Insurance Companies are quite known in long-term leasing, particularly in the case of real estate. Usually a life insurance company has a large cash inflow which can easily be invested as the amount is not immediately required for the payment of policies. As such, these excess cash can easily be invested by them in office-building, warehouse which can be leased to the occupants.

Fund Based Activity: Area # 2. Hire-Purchase:

A line-put transaction is one when the seller owner of certain goods delivers has goods to a person (known as hire-purchase) with a condition that he (hire-purchaser) with repay the price of the goods which is inclusive of certain amount of interest) by different specified periodical instalments and acquires the property (goods) immediately but the same is transferred only when the last instalment is paid.

In other words, a hire purchase agreement is one under which a person takes delivery of goods promising to play the price by a certain number of instalments and. until full payment is made, to pay hire charges for using the goods. The law regaining the subject has been codified by the parliament in 1972 viz the Hire-Purchase Act (No 25 of 1972).

Generally a certain sum of money is paid at the time of taking delivery known as down payment' or 'initial payment' and the instalment is paid at the end of the period, say, yearly, half-yearly or quarterly. Needless to mention here that the total payment made under hire purchase agreement should always be higher than the cash price since interest is charged with cash price of hire-purchase transactions.

Legal Position/Hire-Purchase Agreement:

The Hire-Purchase Act came into being on 1st Sept 1972. According to the Act, a hire-purchase agreement means "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 thereof to a person on condition that such person pays the agreed amount in periodical installments, and (ii) The property in the goods is to pass to such person on the payment of the last of such instalments, and (iii) Such person has a right to terminate the agreement at any time before the property so passess "— Sec. 2 (c).

"Hire-purchase agreement must be in writing and signed by parties. A surity, if any, must sign the hire-purchase agreements. The agreement shall be void if the above requirements have not been complied with"— Sec. 3.

According to Sec. 4 the contents of hire-purchase agreement which includes the following:

(i) The hire-purchase price of the goods to which the agreement relates;

(ii) The case price of the goods i.e., the price at which the goods may be purchased by the hirer for cash;

(iii) The date on which the agreement shall be deemed to have commenced;

(iv) the number of installments by which the hire-purchase price is to be paid, the amount of each of those instalments and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable;

(v) The goods to which the agreement relates, in a manner sufficient to identify them;

(vi) where any part of the hire-purchase price is, to be paid otherwise than by cash or by cheque, the hire-purchase agreement shall contain a description of that part of the hire-purchase price; and

(vii) where any of the above requirements has not been complied with, the hirer may institute a suit for getting the hire-purchase agreement rescind, and the court may, if it is satisfied that the failure to comply with any such requirement has prejudiced the hirer, rescind the agreement on such terms as it thinks just, or pass such other order as it thinks fit in the circumstances of the case.”

Certain Terms used in Hire-Purchase Agreement:

The following terms are widely used in hire-purchase transactions:

(a) Price:

The H. P. Act defines various terms in relation to prices which are noted below:

(i) Cash Price Installment:

An amount which bears to the net price the same proportion as the amount of the hire-purchase instalment bears to the total amount of hire- purchase price.

(ii) Hire-Purchase Price:

The total sum payable by the hirer as per hire-purchase terms in order to complete the transactions.

(iii) Net Hire-Purchase Charges:

The difference between the net hire-purchase price and the net cash price of the goods.

(iv) Net Cash Price:

Total cash price less any deposit.

(v) Down Payment:

The amount which is paid at the time of taking delivery of the goods.

(vi) Net Hire-Purchase Price:

Total amount of hire-purchase price minus:

(a) Delivery expenses, if any;
(b) Registration or other kinds of fees related to agreement; and
(c) Insurance expenses, if any.

(b) Hirer:

The person who obtains the possession of goods from the owner under a hire-purchase agreement.

(c) Hire:

The sum payable periodically by the hirer under the agreement.

(d) Installment:

The amount which is inclusive of interest together with principle paid at the end of the period.

Limitation of Hire-Purchase Charge:

It has been pointed out above that (Net) hire-purchase charge is the difference between the net hire-purchase price and the net cash price of the goods. To avoid the exorbitant hire charges levied by the owner. Sec. 7 has been introduced by the Government which states that the maximum statutory charge may be @ 30% of the instalment, or, the charges may be ascertained with the help of the following formula:

SC = CI x R x T /1000

where, SC = the statutory charges,

CI = the amount of cash price installment expressed in rupee or fraction of rupee,

R = the rate, and

T = the time, expressed in years and fractions of years, that elapse between the date of the agreement and the date on which the hire-purchase instalment corresponding to the cash price instalment is payable under the agreement.

Fund Based Activity: Area # 3. Bill Discounting:

When the holder of a bill wants to get the money before the due date, he can sell the bill to a bank against a small charge, known as discounting charges i.e., a supplier or creditor of goods discounts the incomes for sale of goods.

Discounting charge is imposed by the bank at a fixed rate present p. a from the date of discounting to the date of maturity. At present in our country, through the discounting of bills of exchange a major part of lending of money taken place by commercial banks.

However, a clean bill carries only the personal security of the drawer and drawee, but a documentary bill, however, accompanied by Bill of Lading, Railway Receipt or other documents of title of goods, which provide extra security in addition to the personal security of the drawer and drawee.

It is needless to say that if the bill is dishonored by the drawee/drawer, the bank naturally will recover the amount from the drawer/creditor of the bill.

Fund Based Activity: Area # 4. Factoring:

A factor is a financial institution who takes the responsibility of financing and collecting debts that may arise out of credit sales. It is done on a continuous basis. Under the arrangement as soon as new bills receivables come in they are taken by the factor and the proceeds are credited to the accounts of the client correspondingly.

If there is no default or irregularities overdraft facility may also be allowed In Western country, factoring is well-established.

But in our country, factoring have been set up by nationalized banks only in four regions, viz:

(i) State Bank of India (in the West);
(ii) Canara Bank (in the south);
(iii) Punjab National Bank (in the north); and
(iv) Bank of Allahabad (in the east)

However, RBI Study Group suggested that there is greater scope of factoring in India and the demand has been estimated at about 4.000 crores. They also suggested that in the case of Textile, Engineering, Automobile Ancillaries, Chemicals and Consumer Durable industries factoring services are urgently needed.

Characteristics of a Factoring Arrangement:

The significant characteristics of a factoring arrangement are presented below:

(i) The factor takes the responsibility for realising/collecting the debts. It pays to the client when the amount is collected or at the end of the credit period which one is earlier for each and individual transaction.

(ii) Usually, the factors take a commission of 1% to 3% of the face value of the debt.

(iii) It may be on the following two basis:

(a) Recourse basis (when risk is borne by the client);
(b) Non-recourses basis (when risk is borne by the factor).
In our country, however the former one is taken into consideration.
(iv) The factor usually advanced 70% to 80% of the face value of the debt and the rate of interest becomes a slight higher than the prevailing bank rate although the factor advances the credit against not yet dud not yet collected debts to the clients.

Fund Based Activity: Area # 5. Venture Capital:

Venture capital implies the financial investment to high-tech growing companies (i.e., higher risk based) as equity capital with the expectation of a higher rate of return which is inclusive of initial as well as development capital for a company.

Although the concept is very old, it is not widely accepted. Sometimes, this capital is being introduced as a result of the product of any scientific improvement and technology and to bring it into real world situation. It also helps the new companies to issue shares who find it difficult.

Features/Characteristics

It is to be noted that there is no such standard form on which venture capital will be supplied.

However, the following characteristics are denoted:

(i) In the first two years, the financial burden becomes negligible;
(ii) The venture capital firms take a high degree risk with the expectation of a high rate of return in future;
(iii) Usually, the venture capital firms desires to liquidate its investment after 3 to 5 year; and
(iv) The Venture Capital firm takes the active participation in the management of the assisted firm including the help extended to procure fund

Venture Capital Scheme of India:

At first, the Industrial Finance Corporation of India (IFCI) took the pioneering effort relating to venture capital by setting up the Risk Capital Foundation in 1975. Later on, it was converted into the Risk Capital and Technology Finance Corporation Ltd. in 1988.

Moreover, Investment Credit and Investment Corporation of India (ICICI), Industrial Development Bank of India (IDBI), Unit Trust of India (UTI) and Canara Bank also started their venture capital funds in India.

Some of the above schemes introduced by the above financial institutions are explained below:

(a) Venture Capital Scheme of ICICI:

In 1986, ICICI started its newly promoted company as Technology Development and Investment Corporation of India (TDIC1) in order to take over its Venture Capital Operation in the country.

Its main characteristic are:

(i) The Technology Development and Investment Corporation of India invests in various companies in order to earn long-term capital gains along with the highly potential growth and earnings.

(ii) TDICI can assist up to Rs. 2 crores either in the form of equity shares or in the form of conditional loans per project.

(iii) The said conditional loan will not carry any interest during the period of development and after that period, the rate of interest will be ascertained on the basis of commercial viability.

(iv) The equity, on the other hand, may be retained against the period of 5 to 8 years and after the period is over, the same may be sold either in the open market or to the promoter at the accepted price.

(v) TDICI also becomes ready to help those technocrats who are associated with the development of technology, or various products or untested technologies on a commercial basis.

(vi) It is ready to meet the long term needs of private industry for both domestic and foreign capital. Thus, the ICICI via TDICI, primarily finances the purchase of capital assets and provides also managerial, technical and administrative advice to the assisted companies.

(b) Venture Capital Scheme of IDBI:

The Industrial Development Bank of India (IDBI) was set up in 1964 in order to provide long-term finance to industry. It was set up as a subsidiary of the RBI but was delinked from it in the year 1975 and was running at an autonomous corporation.

It is an apex body to co-ordinate the operation of other institutions to supply term-finance to industry as well as an agency to provide direct financial assistance to industrial units. However, the Venture Capital Scheme of the Industrial Development Bank of India was establish having an initial capital of Rs. 10 crores.

The significant characteristics of the scheme are noted below:

(i) IDBI usually provides 80% to 90% of the total projected cost and the balance must be supplied by the promoters themselves.

(ii) During the period of development, IDBI may provide assistance in between Rs. 5 lakhs and Rs. 2 crores and Rs. 50 lakhs in order to cover each both capital and revenue expenditures.

(iii) IDBI may provide assistance either in the form of equity or in the form of loan. It should be noted that in the case of equity, the service charges to be considered as 1% whereas in the case of loan, the same may be taken at 6% during the period of development. When the period is over, the rate of interest is taken at 14% and such loan should be repaid within a period of 10 years,

(iv) Its primary function is to provide funds to such projects which have commercial importance of various improved technology and also applied imported advance technologies which are rather quite new in the Indian context.

(v) If it is found that the project proves unsuccessful, IDBI will try to transfer to such technology to other promoters.

Cumulative, by March 1993 IDBI has sanctioned and disbursed assistance aggregating Rs. 65,460 crores and Rs. 47,087 crores respectively.

Other Venture Capital Schemes:

In addition to the above, there are other venture capital institutions or schemes in India.

Some of them are described below in short:

(i) SBI Capital Markets:
It has a Bought-out-deal scheme
(ii) Credit Capital Finance Corporation (CCFC):
It is a private venture capital fund.
(iii) National Grindlays Bank:
It induced an Investment fund by taking the amount from Non-Resident Indians.
(iv) Risk Capital and Technology Finance Corporation (RCTFC):
It has already been stated earlier that it is the Risk Capital Foundation which was set up in 1975 was converted into a separate entity in 1988 as RCTFC. It is an independent organization.

Position of Venture Capital in India:
Venture capital is provided to those industries which are going to induce technological development, inducing innovation and creativity in the various commercial fields through the promoters.

In order to be more effective the Government, various financial institutions, private sectors including other agencies/organisations should take the necessary steps for the growth and development of venture capital in our country. In short it becomes necessary to establish a favourable fiscal and regulatory surroundings and also to extend the necessity of venture capital finance in the field of commercial entity.

Suggestions to create a favourable condition for the growth and development of venture capital through fiscal and regulatory measures

For the growth and development of the venture capital a favourable fiscal as well as regulatory measures must be taken into considerations.

Some of them may be enumerated as under:
(i) From Taxation Point of View:
(a) The long-term capital gains arising out of venture capital either should be exempted from tax or may be taxed at a lower rate;
(b) A greater tax relief may be given to the investor who will subscribe and help to raise funds for venture capital.
(ii) From Investors Point of View:
In order to encourage the foreign investors who directly help to create venture capital fluids should be given some liberal facilities for them.
(iii) From its Application Point of View:
Its area of activities should be extended i.e., it will finance not only its own operation but also to help it, other assisted units from the standpoint of commercial activities.

Capital market services and money market Services

Capital and money markets

Capital and money markets are the platform where governments and numerous corporations raise money from stakeholders in return for the promise of future revenues.

1. Capital market: Capital market is the market where investment instruments like bonds, equities and mortgages are traded. It is a market which deals in long-term loans. It supplies industry with fixed and working capital and finances medium-term and long-term borrowings of the central, state and local governments. Major function of this market is to make investment from stockholders who have excess funds to the ones who are running a scarcity. The capital market provides both long term and overnight funds.

In financial literature, bulk of economists elaborated the term, capital market. Gold Smith described "the capital market of a modern economy has two basic functions; first the allocation of savings among users and investments; second the facilitation of the transfer of the existing assets, tangible and intangible among individual economic units." According to Grant, Capital market in a broad sense as "a series of channels through which the savings of the community are made available for industrial and commercial enterprises and for public authorities. It embraces not only the system by which the public takes up long term securities directly or through intermediary but also the elaborate network of institutions responsible for short term and medium term lending."

Such explanation indicate that capital market as the market for long term funds. The capital market provides long term debt and equity finance for the government and the corporate sector. The capital market also enables the dispersion of business ownership and reallocation of financial resources among corporate and industries.

Various types of financial instruments that are traded in the capital markets are as under:

- Equity instruments
- Credit market instruments
- Insurance instruments
- Foreign exchange instruments
- Hybrid instruments
- Derivative instruments

There are two types of capital market which include Primary market and Secondary market

Primary Market: Primary Market is that market in which shares, debentures and other securities are sold for the first time to collect long-term capital. This market is concerned with new issues. Therefore, the primary market is also called new issue market. In this market, the flow of funds is from savers to borrowers (industries), therefore, it helps directly in the capital formation of the country. The money collected from this market is normally used by the companies to improve the plant, machinery and buildings, for extending business, and for establishing new business unit.

Features of Primary Market:

The first characteristic of the primary market is that it is related with the new issues. Whenever a company issues new shares or debentures, it is known as Initial Public Offer.

Primary market is not the name of any particular place but the activity of bringing in new issues.

It has several Methods of Floating Capital. Methods of raising capital in the primary market are as follows.

Public Issue: In this technique, the company issues a prospectus and invites the general public to purchase shares or debentures.

Offer for Sale: Under this process, initially the new securities are offered to an intermediary (generally firms of stock brokers) at a fixed price. They further resell the same to the general public. The benefit of this method is that the issuing company feels free from the tedious work of making a public issue.

Private Placement: This process entails that the company sells securities to the institutional investors or brokers instead of selling them to the general public. They, in turn, sell these securities to the selected clients at a higher price. This method is considered as it is a cheaper method to raise funds as compared to a public issue.

Right Issue: This technique is used by companies who have already issued their shares. When an existing company issues new shares, first of all it invites its existing shareholders. This issue is called the right issue. In this case, the shareholder has the right either to accept the offer for himself or assign a part or all of his right in favour of another person.

Electronic Initial Public Issue (e-IPOs): Under this process, companies issue their securities through the electronic medium (i.e. internet). The company issuing securities through this medium enters into a contract with a Stock Exchange.

It Comes before Secondary Market: The transactions are first made in the primary market. The turn of the secondary market comes later.

Benefits of Primary Market:

Manipulation of price is smaller so investment in primary market is safer.

No need to time the market the investors get the share at the same price.

It is secure because of primary research data is collected directly by the organization that deploys the research

The company receives the money and issues new security certificates to the investors.

Actions in the Primary Market:

Appointment of merchant bankers

Pricing of securities being issued

Communication/ Marketing of the issue

Information on credit risk

Making public issues

Collection of money

Minimum subscription
Listing on the stock exchange(s)
Allotment of securities in demat / physical mode
Record keeping

Secondary market: The secondary market is that market in which the buying and selling of the formerly issued securities is done. The transactions of the secondary market are usually done through the medium of stock exchange. The main aim of the secondary market is to create liquidity in securities.

Features of Secondary Market:
It Creates Liquidity
It Comes After Primary Market
It Has A Particular Place
It Boosts New Investments
Benefits of Secondary Market:
The investors can recover their investments to a certain extent, provided their economic status undergoes a change.
In such cases the investors may refrain from making long term investments.
Investor can get large interest by invest for a longer period of time.
Activities in the Secondary Market:
Trading of securities
Risk management
Clearing and settlement of trades
Delivery of securities and funds

Significance of capital market:
The capital market has significant role in mobilising saving and contribute into productive investments for the development of commerce and industry. The capital market helps in capital formation and economic development of the country.
Economists stated that the capital market acts as a strong link between savers and investors. The savers are lenders of funds while investors are borrowers of funds. The savers who do not spend all their income are called Surplus unitsand the borrowers are known as deficit units. The capital market is the transmission device between surplus units and deficit units. It is a channel through which surplus units lend their surplus funds to deficit units
Funds flow into the capital market from individuals and financial mediators which are absorbed by business, industry and government. It allows the movement of stream of capital to be used more effectively and profitability to boost the national income.

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

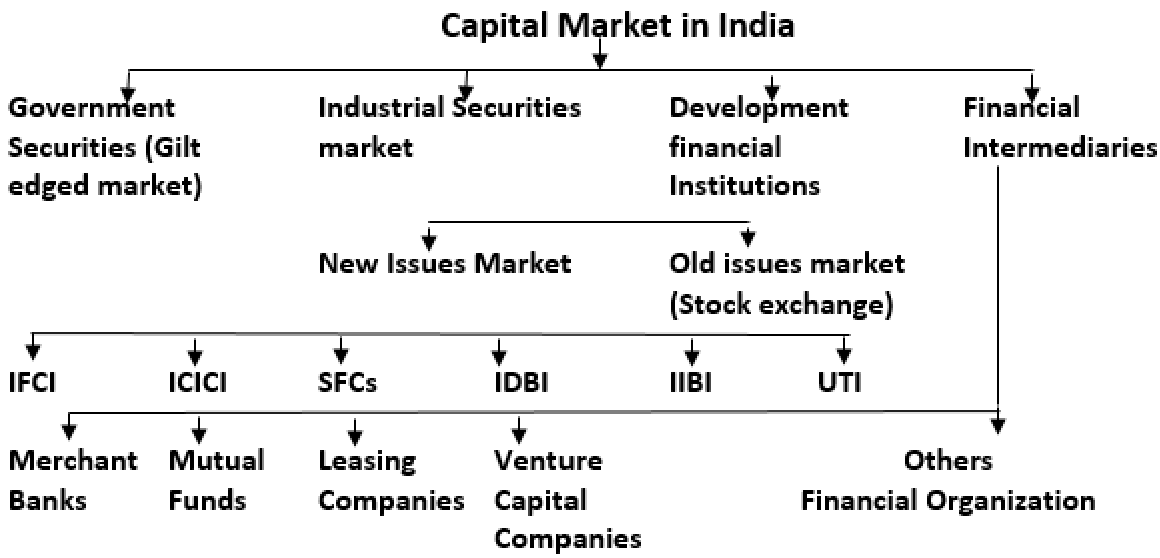
An organized and matured capital market comprising expert banking and non-banking intermediaries brings strength in the value of stocks and securities. It does so by providing capital to the needy at reasonable interest rates and helps in reducing speculative activities.

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

In an underdeveloped country where capital is limited, the absence of a developed capital market is a greater interference to capital formation and economic development. Even though the people are poor, yet they do not have any inducements to save. Others who save, they invest their savings in wasteful and unproductive channels, such as gold, jewellery, real estate, conspicuous consumption, etc. Such countries can encourage people to save more by establishing banking and non-banking financial institutions for the existence of a developed capital market. Such a market can go a long way in providing a link between savers and investors, thereby leading to capital formation and economic progress.

The capital market in India is a market for securities, where companies and governments can increase long term funds. The Indian Equity Market is fully controlled by two major stock exchanges -National Stock Exchange of India Ltd. (NSE) and The Bombay Stock Exchange (BSE). The benchmark indices of the two exchanges - Nifty of NSE and Sensex of BSE are closely monitored by the investors.

In Indian capital market, there are following members which smoothly operate functions of market:
India Capital Markets Pvt. Ltd.- Members NSE, BSE and NSDL,
ICM Commodities Pvt Ltd. Members MCX, NCDEX
SEBI Registered PMS



The functions of the Indian Capital Market: These are as follows:

1. Publicise information efficiently for enabling participants to develop an informed opinion about investment, disinvestments, reinvestment, or holding a particular financial asset.
2. Allowing quick valuation of financial instruments-both equity and debt.
3. Providing insurance against market risk or price risk through derivative trading and default risk through investment protection fund.
4. Empower more participation by enhancing the width of the market by encouraging participation through networking institutions and associating individuals.
5. Provide operational efficiency through:
   a. Simplified transaction procedure.
   b. Lowering settlement timings.
   c. Lowering transaction costs.
6. Develop integration among:
   a. Real sector and financial sector.
   b. Equity and debt instruments.
   c. Long-term and short-term funds.
   d. Long-term and short-term interest costs.
   e. Private sector and government sector.
   f. Domestic funds and external funds.
7. Direct the flow of funds into efficient channels through investment, disinvestments, and reinvestment.

The capital market boosts economic growth by mobilizing the savings of the economic sectors and directing the same towards channels of prolific uses. This is enabled through the following:

1. The Industrial Financial Corporation of India (IFC).
2. The Industrial Credit and Investment Corporation of India (ICICI).

3. The Refinance Corporation of India (RFC).
4. The State Financial Development Corporations (SFCs).
5. National Industrial Development Corporation (NIDC).
6. The State Industrial Development Corporation (SIDCs).
7. National Small Industries Corporation (NSIC).
8. Industrial Development Bank of India (IDBI).
9. Life Insurance Corporation of India (LIC).
10. Nationalized Commercial Banks (NCBs).
11. Merchant Banking Institutions (MBIs).
12. National Industrial Reconstruction Corporation of India (NIRC).
13. The Credit Guarantee Corporation of India (CGC).
14. Unit Trust of India (UTI)

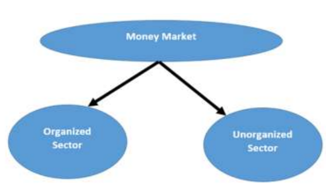
Above members are mainly financial institutions which offer the liquidity that is required to push the machinery of the Capital Market.

2. Money market:

Money market is a tool that manage the lending of short term funds (less than one year). It is a subdivision of the financial market in which financial instrument with high liquidity and very short maturities are traded. There are several money market instruments, including treasury bills, commercial paper, bankers' acceptances, deposits, certificates of deposit, bills of exchange, repurchase agreements, federal funds, and short-lived mortgage-, and asset-backed securities.

Various institutions and economists defined money market in different ways. According to the RBI, "The money market is the centre for dealing mainly of short character, in monetary assets; it meets the short term requirements of borrowers and provides liquidity or cash to the lenders. It is a place where short term surplus investible funds at the disposal of financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government." Nadler and Shipman stated that "A money market is a mechanical device through which short term funds are loaned and borrowed through which a large part of the financial transactions of a particular country or world are degraded. A money market is distinct from but supplementary to the commercial banking system." In money market, transactions of huge amount and high volume take place. It is controlled by few big players. In fact, there are two categories of money market in India that include organized sector and unorganized sector.

Classification of Money Market



Unorganized sector include chit funds, money lenders and indigenous banks. Organized sector include commercial banks in India both public sector and private sector and foreign banks In money market, main players are Government, RBI, DFHI (Discount and finance House of India) Banks, Mutual Funds, Corporate Investors, Provident Funds, PSUs (Public Sector Undertakings), NBFCs (Non-Banking Finance Companies).

Major functions of money market:

1. It furnishes to the short-term financial needs of the economy.
2. It helps the RBI in effective implementation of monetary policy.
3. It provides mechanism to achieve equilibrium between demand and supply of short term funds.
4. It helps in allocation of short term funds through inter-bank transactions and money market Instruments.
5. It also provides funds in non-inflationary way to the government to meet its deficits.
6. It expedites economic growth.

Feature of money market:

- Constituents of Money Market
- Heterogeneous Market
- Dealers of Money Market
- Short-term Loans
- Different from Capital Market
- Association with Big Cities
- Change with Place and Time

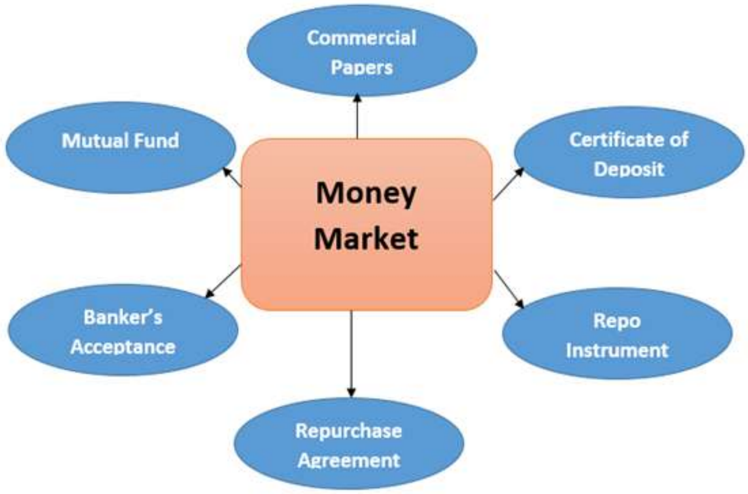
Characteristics of A Developed Money Market:

- Existence of Central Bank
- Highly organized commercial Banking System
- Existence of sub-markets
- Integrated structure of money market
- Availability of proper credit instruments
- Adequacy and Elasticity of funds
- International attraction
- Uniformity of interest rates
- Stability of prices
- Highly developed Industrial system

Importance of Money Market:

There is more significance of money market in financing Industry, financing trade, self-sufficiency of banks and effective implementation of monetary policy. Money market encourages economic growth and help to government for proper allocation of resources. Instrument of Money Market are treasury bills, commercial bills, money at call, promissory notes.

Some new instruments in money market:



Disadvantages of Indian Money Market:

Though the Indian money market is reflected as the progressive money market among developing countries but it still suffers from several drawbacks. These defects limit the productivity of market.

Absence of Integration: The Indian money market is basically divided into the Organized and Unorganized Sectors. The organized sector comprises the legal financial institutions backed by the RBI. The unorganized statement of it includes various institutions such as indigenous bankers, village money lenders, traders. There is lack of proper incorporation between these two segments.

Multiple rate of interest: In the Indian money market, particularly the banks, there are variable rates of interests. These rates vary for lending, borrowing, government activities, etc. Many rates of interests create confusion among the investors.

Inadequate Funds or Resources: The Indian economy with its seasonal structure suffer from frequent shortage of financial recourse. Lower income, lower savings, and lack of banking habits among people are some of the reasons for it.

Shortage of Investment Instruments: In the Indian money market, various investment instruments such as Treasury Bills, Commercial Bills, Certificate of Deposits, Commercial Papers, etc. are used. But taking into account the size of the population and market these instruments are insufficient.

Shortage of Commercial Bill: It is observed that in Indian money market, as many banks keep large funds for liquidity purpose, the use of the commercial bills is very limited. Correspondingly since a large number of transactions are preferred in the cash form, the scope for commercial bills are limited.

Lack of Systematized Banking System: In India, though there is huge network of commercial banks, still the banking system suffers from major flaws such as the NPA, huge losses, and poor efficiency. The absence of the organized banking system is major problem for Indian money market.

Less number of Dealers: There are less dealers in the short-term assets who can act as mediators between the government and the banking system. The less number of dealers leads to the slow contact between the end lender and end borrowers.

Money market is differentiated from capital market on the grounds of the maturity period, credit instruments and the institutions.

1. Maturity Period: The money market is involved in the lending and borrowing of short-term finance whereas the capital market deals in the lending and borrowing of long-term finance.
2. Credit Instruments: The main credit mechanisms of the money market are call money, collateral loans, acceptances, bills of exchange. In contrast, the main instruments used in the capital market are stocks, shares, debentures, bonds, securities of the government.
3. Nature of Credit Instruments: The credit instruments allocated in the capital market are more heterogeneous as compared to money market. Some homogeneity of credit instruments is needed for the operation of financial markets. Too much diversity creates problems for the investors.
4. Institutions: Important institutions operating in the money market are central banks, commercial banks, acceptance houses, nonbank financial institutions, and bill brokers. Important institutions of the capital market are stock exchanges, commercial banks and nonbank institutions, such as insurance companies, mortgage banks, and building societies.

Non-bank financial intermediaries (NBFIs) comprise a mixed bag of **institutions**, ranging from leasing, factoring, and venture capital **companies** to various types of contractual savings and institutional investors (pension funds, insurance **companies**, and mutual funds).

Difference # Financial Intermediaries:

Financial intermediaries generally include commercial banks, cooperative credit societies, building societies, insurance companies, etc. They act as half-way houses between the primary lenders and the final borrowers. They accept deposits from the public and pay deposit rates to it.

The financial intermediaries obtain funds from the public and lend these funds to investors. The difference between the lending and the borrowing rates are the profits of the financial intermediaries. The financial intermediaries can also buy bonds and stocks with the acquired funds.

As the economy grows and the financial system develops, financial institutions (or financial intermediaries) emerge to perform the function of transferring funds from savers to the investors. This process of transferring saving funds to business investments is known as financial intermediation.

The process of financial intermediation operates through a varieties of financial assets (or credit instruments), such as time deposits, bills of exchange, bonds, mortgages, etc. These financial assets are traded by different financial institutions in many different financial markets. If the primary savers decide to lend to the financial borrowers directly (i.e., decide to eliminate financial intermediaries), then dis-intermediation will occur. Financial intermediaries perform the function of transferring funds from savers to investors.

The transfer of funds from savers to investors can occur in two ways:
(a) Savers can lend funds to the investors directly. This is called direct financing. Businesses can sell stocks or bonds directly to the public in primary markets. The public can increase the liquidity of these financial assets by reselling them in secondary markets.

A market in which newly issued credit instruments are bought and sold is called primary market and a market in which previously issued credit instruments are bought and sold is secondary market.

(b) When the funds are transferred from savers to investors through financial intermediaries, it is called indirect financing. The liabilities of financial intermediaries are called indirect debt. For example, commercial banks accept demand deposits and saving deposits; thrift institutions accept time deposits; insurance companies accept premium payments. In turn, the financial intermediaries purchase assets, i.e., relend the funds.

Difference # Non – Bank Financial Intermediaries (NBFIs):
Financial intermediaries are generally classified into two broad groups- (a) banks, and (b) non-bank financial intermediaries (NBFIs). Non-bank financial intermediaries are thus a heterogeneous group of financial institutions other than commercial banks.

NBFIs include such institutions as life insurance companies, mutual savings banks, pension funds, building societies, etc. NBFIs have made considerable progress after World War I.
Their growth has been much faster than that of commercial banks. The main reason for this is that, in comparison to commercial banks, NBFIs pay higher interest rates to the depositors and charge lower interest rates from the borrowers.

NBFC

Non-banking financial companies (NBFCs) are financial institutions that offer various banking services but do not have a banking license. Generally, these institutions are not allowed to take traditional demand deposits—readily available funds, such as those in checking or savings accounts—from the public. This limitation keeps them outside the scope of conventional oversight from federal and state financial regulators.

NBFCs can offer banking services such as loans and credit facilities, currency exchange, retirement planning, money markets, underwriting, and merger activities.

Shadow Banks and Meltdowns

However, NBFCs had existed long before the Act. In 2007, they were given the moniker "shadow banks" by economist Paul McCulley, at the time the managing director of Pacific Investment Management Company LLC (PIMCO), to describe the expanding matrix of institutions contributing to the then-current easy-money lending environment—which in turn led to the subprime mortgage meltdown and the subsequent 2008 financial crisis.

Although the term sounds somewhat sinister, many well-known brokerages and investment firms were engaging in a shadow-banking activity. Investment bankers Lehman Brothers and Bear Stearns were two of the more famed NBFCs at the center of the meltdown.

As a result of the ensuing financial crisis, traditional banks found themselves under closer regulatory scrutiny, which led to a prolonged contraction in their lending activities. As the authorities tightened up on the banks, the banks, in turn, tightened up on loan or credit applicants. The more stringent requirements gave rise to more people needing other funding sources—and hence, the growth of non-bank institutions that were able to operate outside the constraints of banking regulations.

In short, in the decade following the financial crisis of 2007-08, NBFCs have proliferated in large numbers and varying types, playing a key role in meeting the credit demand unmet by traditional banks.

NBFC Controversy

Advocates of NBFCs argue they these institutions play an important role in meeting the rising demand for credit, loans, and other financial services. Customers include both businesses and individuals—especially those who might have trouble qualifying under the more stringent standards set by traditional banks.

Not only do NBFCs provide alternate sources, proponents say, they also offer more efficient ones. NBFCs cut out the middleman—as banks often are—to let clients deal with them directly, lowering costs, fees, and rates, in a process called disintermediation. Providing financing and credit is important to keep the money supply liquid and the economy humming.

Even so, critics are troubled by NBFCs' lack of accountability to regulators and their ability to operate outside the customary banking rules and regulations. In some cases, they may face oversight by other authorities—the Securities and Exchange Commission (SEC) if they're public companies, or the Financial Industry Regulatory Authority (FINRA) if they're brokerages. However, in other cases, they may be able to operate with a lack of transparency.

All of this could put an increasing strain on the financial system. NBFCs were at the epicenter of the 2008 financial crisis that led to the Great Recession. Critics cite that, after all, they have only increased in numbers since then.

Pros

- Alternate source of funding, credit
- Direct contact with clients, eliminating intermediaries
- High yields for investors
- Liquidity for the finance system

Cons

- Non-regulated, not subject to oversight
- Non-transparent operations
- Systemic risk to finance system, economy

Insurance in India refers to the market for insurance in India which covers both the public and private sector organisations. It is listed in the Constitution of India in the Seventh Schedule as a Union List subject, meaning it can only be legislated by the Central Government only.

The insurance sector has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014.[1] Since the privatisation in 2001, the largest life-insurance company in India, Life Insurance Corporation of India has seen its market share slowly slipping to private giants like HDFC Life, Exide Life Insurance, ICICI Prudential Life Insurance and SBI Life Insurance Company.

Recent Reforms in Financial Sector

Financial sector is the mainstay of any economy and it contributes immensely in the mobilisation and distribution of resources. Financial sector reforms have long been viewed as significant part of the program for policy reform in developing nations. Earlier, it was thought that they were expected to increase the efficiency of resource mobilization and allocation in the real economy to generate higher rates of growth. Recently, they are also seen to be critical for macroeconomic stability. It was due to the repercussion of the East Asian crisis, since weaknesses in the financial sector are broadly regarded as one of the major causes of collapse in that region.

Major aims of the financial sector reforms are to allocate the resources proficiently, increasing the return on investment and hastened growth of the real sectors in the economy. The processes introduced by the Government of India under the reform process are intended to upturn the operational efficiency of each of the constituent of the financial sector.

The major delineations of the financial sector reforms in India were found as under:

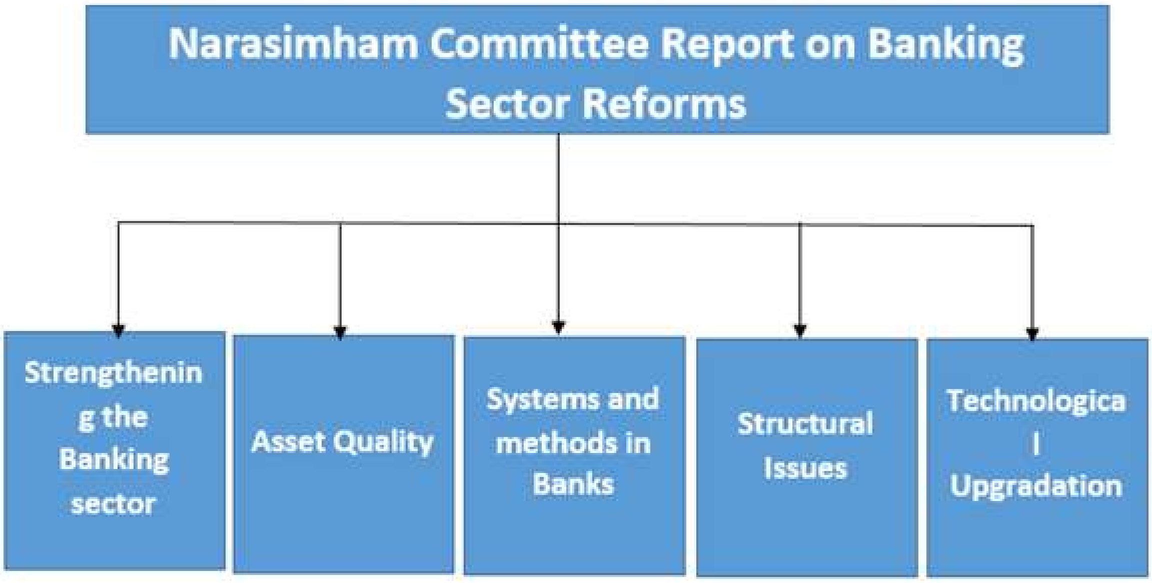
1. Removal of the erstwhile existing financial repression.
2. Creation of an efficient, productive and profitable financial sector.
3. Enabling the process of price discovery by the market determination of interest rates that improves allocate efficiency of resources.
4. Providing operational and functional autonomy to institutions.
5. Preparing the financial system for increasing international competition.
6. Opening the external sector in a calibrated manner.
7. Promoting financial stability in the wake of domestic and external shocks.

At global level, financial sector reforms have been driven by two apparently contrary forces. The first is a thrust towards liberalization, which seeks to decrease, if not eliminate a number of direct controls over banks and other financial market participants. The second is a thrust in favour of strict regulation of the financial sector. This dual approach is also apparent in the reforms tried in India.

Financial and banking sector reforms are in following areas:
Financial markets
Regulators
The banking system
Non-banking finance companies
The capital market
Mutual funds
Overall approach to reforms
Deregulation of banking system
Capital market developments
Consolidation imperative

Regulators

The Finance Ministry constantly formulated major strategies in the field of financial sector of the country. The Government acknowledged the important role of regulators. The Reserve Bank of India (RBI) has become more independent. Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) became important institutions. Some opinions are also there that there should be a super-regulator for the financial services sector instead of multiplicity of regulators.



Indian Banking Sector and Financial Reforms
The main intent of banking sector reforms was to uphold a diversified, efficient and competitive financial system with the aim of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional solidification.

As early as August 1991, the government selected a high level Committee on the Financial System (the Narasimham Committee) to look into all facets of the financial system and make comprehensive recommendations for improvements. The Committee submitted its report in November 1991, making several recommendations for reforms in the banking sector and also in the capital market. Soon thereafter, the government announced broad acceptance of the approach of the Narasimham Committee and a process of gradualist reform in the banking sector and in the capital market was set in motion, a process that has now been under way for more than six year.

In India, around 80% of businesses are regulated by public sector banks. PSBs are still governing the commercial banking system. The RBI has given licenses to new private sector banks as part of the liberalization process. The RBI has also been granting licenses to industrial houses. Many banks are effectively running in the retail and consumer segments but are yet to deliver services to industrial finance, retail trade, small business and agricultural finance. Major change observed by individuals is many transformation in policies of the banking sector. The reforms have focussed on eliminating financial repression through reductions in statutory pre-emptions, while stepping up prudential regulations at the same time. Additionally, interest rates on both deposits and lending of banks have been gradually deregulated.

The major reforms relating to the banking system were:

- Capital base of the banks were strengthened by recapitalization, public equity issues and subordinated debt.

- Prudential norms were introduced and progressively tightened for income recognition, classification of assets, provisioning of bad debts, marking to market of investments.
- Pre-emption of bank resources by the government was reduced sharply.
- New private sector banks were licensed and branch licensing restrictions were relaxed.
- Similarly, several operational reforms were introduced in the area of credit policy:
- Detailed regulations relating to Maximum Permissible Bank Finance were abolished.
- Consortium regulations were relaxed substantially.
- Credit delivery was shifted away from cash credit to loan method.

Many reports signified that the initial steps have been taken in the form of allowing new banks to set up shop. Private Corporates, public sector entities and Non-Banking Finance Companies with a strong track record can now apply to set up new banks and the Reserve bank of India will consider these applications in the coming months. The addition of new banks will mean more competition for this sector in the country and it will lead to a development in services for the end customer. It is anticipated to increase financial enclosure as more and more people across the country will be able to access banking facilities. In reforms for the existing banks the public sector banks have been allowed to increase or decrease the authorised capital without the presence of an overall ceiling. This will provide greater flexibility to the banks to conduct their fund raising activities as per the requirements. The strict restriction of voting rights in banks will also be relaxed and this will aid the banking sector to develop, as large investors will be able to get a bigger voice in the coming days in the banks and the manner in which they operate.

When evaluating banking sector reform, it can be identified that banks have experienced strong balance sheet growth in the post-reform period in an environment of operational flexibility. Enhancement in the financial health of banks, reflected in noteworthy improvement in capital adequacy and improved asset quality, is distinctly observable. It is striking that this progress has been realised despite the espousal of international best practices in prudential norms. Competitiveness and productivity gains have also been enabled by proactive technological deepening and flexible human resource management. These significant gains have been achieved even while renewing goals of social banking viz. maintaining the wide reach of the banking system and directing credit towards important but underprivileged sectors of civilisation.

Forex market reform:
Forex market reform took place in 1993 and the successive adoption of current account convertibility were the acmes of the forex reforms introduced in the Indian market. Under these reforms, authorised dealers of foreign exchange as well as banks have been given greater sovereignty to perform in activities and numerous operations. Additionally, the entry of new companies have been allowed in the market. The capital account has become effectively adaptable for non-residents but still has some reservations for residents.

The growth of financial sector in India at present is nearly 8.5% per year. The rise in the growth rate suggests the growth of the economy. The financial policies and the monetary policies are able to sustain a stable growth rate. The reforms pertaining to the monetary policies and the macro economic policies over the last few years has influenced the Indian economy to the core. The major step towards opening up of the financial market further was the nullification of the regulations restricting the growth of the financial sector in India. To maintain such a growth for a long term the inflation has to come down further.

The financial sector in India had an overall growth of 15%, which has exhibited stability over the last few years although several other markets across the Asian region were going through a turmoil. The development of the system pertaining to the financial sector was the key to the growth of the same. With the opening of the financial market variety of products and services were introduced to suit the need of the customer. The Reserve Bank of India (RBI) played a dynamic role in the growth of the financial sector of India. The growth of financial sector in India was due to the development in sectors

Growth of the banking sector in India

The banking system in India is the most extensive. The total asset value of the entire banking sector in India is nearly US$ 270 billion. The total deposits is nearly US$ 220 billion. Banking sector in India has been transformed completely. Presently the latest inclusions such as Internet banking and Core banking have made banking operations more user friendly and easy.

Growth of the Capital Market in India

The ratio of the transaction was increased with the share ratio and deposit system
The removal of the pliable but ill-used forward trading mechanism
The introduction of infotech systems in the National Stock Exchange (NSE) in order to cater to the various investors in different locations
Privatization of stock exchanges

Growth in the Insurance sector in India

With the opening of the market, foreign and private Indian players are keen to convert untapped market potential into opportunities by providing tailor-made products.

The insurance market is filled up with new players which has led to the introduction of several innovative insurance based products, value add-ons, and services. Many foreign companies have also entered the arena such as Tokio Marine, Aviva, Allianz, Lombard General, AMP, New York Life, Standard Life, AIG, and Sun Life. The competition among the companies has led to aggressive marketing, and distribution techniques. The active part of the Insurance Regulatory and Development Authority (IRDA) as a regulatory body has provided to the development of the sector.

Growth of the Venture Capital market in India

The venture capital sector in India is one of the most active in the financial sector inspite of the hindrances by the external set up. Presently in India there are around 34 national and 2 international SEBI registered venture capital funds

POSSIBLE QUESTIONS

PART-A

Multiple Choice Questions

Online Examination

PART-B

1. What is a insurance corporation?
2. Explain Intermediaries.
3. What are the types of financial services?
4. **What is** Capital market services?
5. Define money market Services.

PART-C

1. Discuss Objectives of financial services.
2. Differentiate fund based and fee based services.
3. Explain in detail banking Financial Corporation
4. Discuss about the growth oriented Mutual Funds
5. Discuss the Non- banking financial Corporations.
6. Discuss the growth of financial services in India.
7. Evaluate the various Financial Service Sector Problems and Reforms.

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 _______	lic 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	SPC & SPE	SPC & SPE
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

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 –

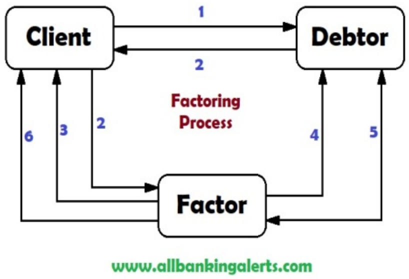
1. **Debtor (Buyer of Goods) –** One who has purchase goods or services on credit and has to pay for same once the credit period gets over.

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.

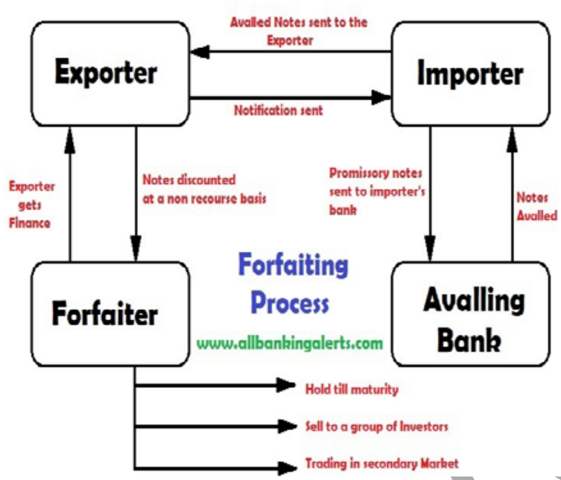
Forfaiting is a specialized form of factoring which is undertaken on export transactions on a non recourse basis. The major parties involved in a transaction of Forfeiting are : An exporter, an importer, a domestic bank, a foreign bank and a primary forfeiter.

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

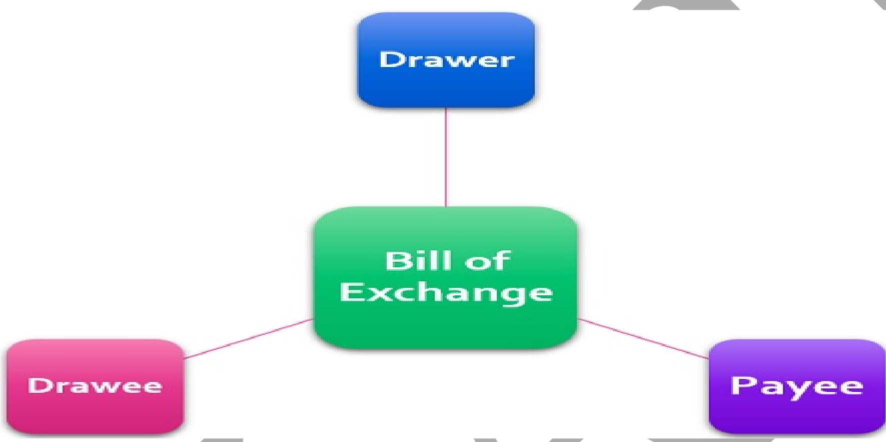
Definition: Bill of Exchange, can be understood as a written negotiable instrument, that carries an unconditional order to pay a specified sum of money to a designated person or the holder of the instrument, as directed in the instrument by the maker. The bill of exchange is either payable on demand,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



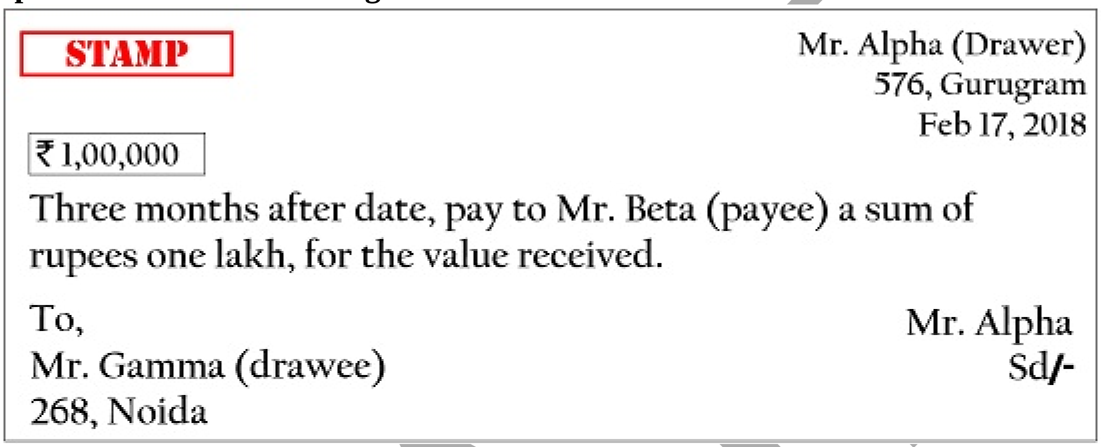
1. **Drawer**: The person who makes the bill, or who gives the order to pay a certain sum of money, is the drawer of the instrument.
2. **Drawee**: The person who accepts the bill of exchange, or who is directed to pay a certain sum, is called drawee.
3. **Payee**: The person receiving payment is called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

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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.

Unit 3

S.No	Questions	Option 1	Option 2	Option 3	Option 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	Merits	Demerits	Functions	Features	Features

	term fund, credit protection, Helps to increase sales are the ______ of a a factor					
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	Finance & Maintenance of Accounts	Collection of Debts & Protection against risk	Finance & Maintenance of Accounts and Collection of	As per agreement	Finance & Maintenance of Accounts and

	and his client which includes at lease two			Debts & Protection against risk		Collection of Debts & Protection against risk
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	Commission	Charge	Fee	Brokerage	Fee

	who collects the dues of his client for a certain___					
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 factoing and Notified factoing is nothing but ____________ factoring	Invoice	Bulk	International	Full Service	Bulk
28	Full Service Factoring is also called as ___________ factoring	With Recourse	Without Recourse	With Course	Without Course	Without Recourse
29	With recourse	Refactoing	Factoring	Full Service	With Recourse	Refactoring

	factoring is also called as ______________ charges					
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	Forfeiting	factoring	financial services	Other Sertices	Forfeiting
41	To be a successful _____________, that there exist a secoundary market	factoring	Forfeiting	Discount services	Financial Services	Forfeiting
42	Exporter, Importer, Forfaiter, Importers' Bank are mechanics of	factoring	MFs	Forfeiting	MBs	Forfeiting
43	Surrender some thing or give up one's right means		factoring	MBs	MFs	Forfeiting

44	Switzerland during the mid 60s developed the concept of	Treasuy Bill	Notes	forfait	G-Sec	Forfait
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,	Forfeiting	factoring	Mutual Funds	Merchant Banks	Forfeiting

	Simple, Flexible, Confidential and Speedy transactins are the merits of					
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	Forfeiting	Bill Financing	Notes	Factoring
57	Sales Ledger, Credit Control and Bad Debts	Factoring Fee	Brokerage	Commission	Discount Charge	Factoring Fee

	administrationi comprises of					
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-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**

$$\text{Loan Instalment} = \frac{\text{Amount of Loan}}{\text{P.V. Factor of Annuity}} = \frac{5{,}00{,}000}{3.127} = ₹\ 1{,}59{,}898 \text{ appx.}$$

***(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

Unit 4

S.No	Questions	Option 1	Option 2	Option 3	Option 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	Sale and	Specialised	Cross Borde	Imported Lease	Sale and

	then continues to use the same asset by getting it on lease from the other firm is	Lease Back Lease	Service Lease	Lease		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	Public & Private sector	All Bankers	Public & Private sector
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	Swap	Wrap	Imported	Balloon	Swap

	orignal asset has to be sent to the lessor for some repair or maintenance					
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	Lessee	Lessor	Leasing	Lease	Lessee

	lease rentals and tax shield on lease rentals are financial implications of				Agreement	
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	Lessor and Lessee	Buyer	Lessor and Lessee
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	Tax Planning	Tax Support	Tax Perquisites	Tax	Tax Planning

	on business expenditures by the lessee					
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 evalutating 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	Yes

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

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

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

where:
n = remaining repayment period (in months)
i.e. 12 months *k* = original repayment period (in months)
i.e. 60 months

Rebate on interest

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

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

= 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	3,20,000×4/10	₹ 1,28,000
Instalment 2	3,20,000×3/10	₹ 96,000
Instalment 3	3,20,000×2/10	₹ 64,000
Instalment 4	3,20,000×1/10	₹ 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.

Credit Rating – Meaning & Functions

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.

Importance of Credit Rating

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.

Unit 5

S.No	Questions	Option 1	Option 2	Option 3	Option 4	Answer
1	Hire Purchase Act was passed in the year	1952	1962	1972	1975	1972
2	Banking Regulation 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	Instalment & HirePurchase	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	Disclosure of Hirer & Hire Vendor Books	Installment	Disclosure of Hirer & Hire Vendor Books
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	NSE and CRISIL Ltd.	NSE and ICRA Ltd.	BSE and CARE Ltd.	BSE and CRISIL Ltd.	NSE and CRISIL Ltd.

	between two entities					
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	Investors & Creditors	Market	Investors & Creditors
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	Quantitative & Qualitative	Financial Data	Quantitative & Qualitative
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	Factors & Parameters	Demerits	Factors & Parameters
37	ICRA do not provides the following	Rating &	Grading &	Evaluation	Crisis	Evaluation

	services	Information	Advisory			
38	Corporate Goverance Rating is done by	CRISIL	ICRA	CARE	S&P	ICRA
39	ICRA mutual fund grading services shall not include	Corporate Reprots	Performance Grading	Credit Risk Grading	Market Risk Grading	Corporate 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	Credit, Market & Operation risk	Credit, Market & Operation risk
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	TRUE	Yes	False	No	Yes

	the rating universe in to industry and instruments					
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