# Unit 1 – Introduction to Financial System

A well functioning financial system is a outcome for the pursuit of economic growth with stability. The core of a well developed financial system is to facilitate smooth and efficient allocation of resources from savers to the ultimate users. An efficient financial system is a key to socioeconomic development. The economic development of any country largely depends on efficiency of the financial system. The well developed financial system helps economy to achieve growth in savings and investment. It also ensures proper functioning of financial intermediaries and facilitates flow of funds from surplus areas to deficit areas. The governments as well as regulators implement suitable policies to make financial system more efficient and vibrant.

## FINANCIAL SYSTEM

The financial system of a country is like the circulatory system of a human body, controls the health of the economy and growth of business and society, through the circulation of money. A healthy economy needs an efficient financial system. The financial system consists of many institutions, instruments, and markets. Financial institutions range from pawnshops and moneylenders to banks, pension funds, insurance companies, brokerage houses, investment trusts and stock exchanges. Financial instruments range from the common — coins, currency notes and cheques, mortgages, corporate bills, bonds and stocks — to the more exotic — futures and swaps of high finance. Markets for these instruments may be organized formally (as in stock or bond exchanges with centralized trading floors) or informally (as in over-the-counter markets). The financial system provides services that are essential in a modern economy. It is a core factor of development and growth. The primary role of any financial system is to act as a conduit for the transfer of financial resources from net savers to borrowers, i.e., from those who spend less than they earn to those who earn less than what they spend.

The services that are provided to a person by the various Financial Institutions like banks, insurance companies, pensions, Mutual funds, etc. constitute the financial system.

**Features of the Indian Financial system:**

- It plays a vital role in the economic development of the country as it encourages both savings and investment
- It helps in mobilising and allocating one's savings
- It facilitates the expansion of financial institutions and markets
- Plays a key role in capital formation
- It helps forms a link between the investor and the one saving
- It is also concerned with the Provision of funds

**Functions of Financial System**

The financial system of a country mainly aims at managing and governing the mechanism of production, distribution, exchange and holding of financial assets or instruments of all kinds.
Financial System performs the following Functions:

1) **Mobilization of Savings**
The financial system encourages individuals, corporate, and others to save for the purpose of economic development. The financial intermediaries play a significant role in mobilization of savings & making available funds to the entrepreneurs for investments. The household & corporate sector saves through use of different financial products. For example, household sector uses bank deposit products & mutual funds products for the savings.

2) **Ensures Liquidity**
The financial system provides liquidity in respect of many financial assets like equity, debt instruments etc. This encourages investors to invest in financial assets. Indirectly this help corporate to raise funds from financial markets through issue of financial instruments. The financial system ensures liquidity for many of these financial assets through strengthening secondary market.

3) **Settlement of Commercial Transactions**
The financial system facilitates settlement of commercial transactions & financial claims arising out of sale & purchase of goods & Services. For this money is used as an instrument which is legally recognized. Therefore values of all transactions including sale & purchase of goods and services are expressed in terms of money only. Over a period of time, the financial system has evolved other instruments like cheques, demand drafts, credit card etc. for settlement of economic transactions. These instruments are recognized by law as a substitute for money. In view of this, market participants use new instruments like credit and debit card as well as new facilities like internet banking and mobile banking for settlement of business and commercial transactions

4) **Implementation of Economic Policies of Government**
The presence of strong financial system helps the Government to frame appropriate economic policies for increasing savings & investment, achieving desired economic growth in industry and agriculture sector, etc. It also facilities government borrowings from the domestic market for meeting planned budgetary expenditures. It also helps Government to attract foreign capital for its investment in domestic market.

5) **Support for Managing Risk in Financial Transactions**
The financial system not only facilitates to execute business and commercial transactions but also helps to manage risk in such transactions. On account of deregulation of financial markets, participants are exposed to various market risk. The financial system offers various financial products like derivative etc. to manage risk in

commercial transactions. The players who are part of financial system use variety of derivative products or financial contracts like forward futures, options and swaps to manage variety types of risk in commercial and business transactions.

**Structure of Indian Financial System**

There are four main components of the Indian Financial System. This includes:

1. Financial Institutions
2. Financial Assets
3. Financial Markets
4. Financial Services

**1. Financial Institutions**

The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilized either directly or indirectly via the Financial Markets.
The main functions of the Financial Institutions are as follows:

- A short term liability can be converted into a long term investment
- It helps in conversion of a risky investment into a risk-free investment
- Also acts as a medium of convenience denomination, which means, it can match a small deposit with large loans and a large deposit which small loans

The best example of a Financial Institution is Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

- **Regulatory –** Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates –** Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates –** Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

**2. Financial Assets**

The products which are traded in the Financial Markets are called the Financial Assets. Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.
Some important Financial Assets have been discussed briefly below:

- **Call Money –** When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.

- **Notice Money –** When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
- **Term Money –** When the maturity period of a deposit is beyond 14 days, it is called term money.
- **Treasury Bills –** Also known as T-Bills, These are Government bonds or debt securities with maturity of less than a year. Buying a T-Bill means lending money to the Government.
- **Certificate of Deposits –** It is a dematerialised form (Electronically generated) for funds deposited in the bank for a specific period of time.
- **Commercial Paper –** It is an unsecured short-term debt instrument issued by corporations.

**3. Financial Markets**

The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.
The financial market can be further divided into four types:

- **Capital Market –** Designed to finance the long term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:
  **(a)**Corporate Securities Market
  **(b)**Government Securities Market
  **(c)**Long Term Loan Market
- **Money Market –** Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for small-term investments only. It is a wholesale debt market which works on low-risk and highly liquid instruments. The money market can further be divided into two types: **(a)** Organised Money Market **(b)** Unorganised Money Market

- **Foreign exchange Market –** One of the most developed markets across the world, the Foreign exchange market, deals with the requirements related to multi-currency. The transfer of funds in this market takes place based on the foreign currency rate.
- **Credit Market –** A market where short-term and long-term loans are granted to individuals or Organisations by various banks and Financial & Non-Financial Institutions is called Credit Market

**4. Financial Services**

Services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include:

- **Banking Services –** Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.
- **Insurance Services –** Services like issuing of insurance, selling policies, insurance undertaking and brokerages, etc. are all a part of the Insurance services
- **Investment Services –** It mostly includes asset management
- **Foreign Exchange Services –** Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services

The main aim of the financial services is to assist a person with selling, borrowing or purchasing securities, allowing payments and settlements and lending and investing.

## ROLE OF THE FINANCIAL SYSTEM IN THE ECONOMIC GROWTH & DEVELOPMENT

### Savings-Investment Relationship

The financial system helps efficiently direct flow of savings and investments in the economy. The financial institutions like banks play a major role. They allow depositors invest money in various deposits like Fixed Deposits and Recurring Deposits by offering attractive rates of interest. These savings are then channelized by the banks to provide credit to different business entities, which are involved in production and distribution. Banks help in the allocation of resources across different sectors of the economy.

### Growth of capital markets

Another important work of finance is to boost growth of capital markets. Businesses need two types of capital – fixed and working. Fixed capital refers to the money needed to invest in infrastructure such as building, plant and machinery. Working capital refers to the money needed to run the business on a day-today basis. This may refer to the ongoing purchase of raw materials, cost of finishing goods and transport of finished goods to stores or customers.
The financial system helps in raising capital in the following ways:

Fixed capital – Businesses issue shares and debentures to raise fixed capital. Financial service providers, both public and private, invest in these shares and debentures to make profits with minimal risk.

Working capital – Businesses issue bills, promissory notes etc. to raise short term loans. These credit instruments are valid in the money markets that exist for this purpose.

### Foreign exchange markets

In order to support the export and import businessmen, there are foreign exchange markets whereby businesses can receive and transmit funds to other countries and in other currencies. These foreign exchange markets also enable banks and other financial institutions to borrow or lend sums in other currencies. Moreover, financial institutions can invest and reap profits from

their short term idle money by investing in foreign exchange markets. Governments also meet their foreign exchange requirements through these markets. Hence, foreign exchange markets impact the growth and goodwill of an economy in the international markets.

**Government securities**

Governments use the financial system to raise funds for both short term and long term fund requirements. Governments issue bonds and bills at attractive interest rates and also provide tax concessions. Budget gaps are taken care of by government securities. Thus, capital markets, foreign exchange markets and government securities markets are essential for helping businesses, industries and governments to carry out development and growth activities of the economy.

**Infrastructure and growth**

The economic growth depends on the growth of infrastructural facilities of the country. Key industries such as power, coal, oil determine the growth of other industries. These infrastructure industries are funded by the finance system of the country. The capital requirement for infrastructure industries is huge. Raising such a huge amount is difficult for private players and hence, traditionally, governments have taken care of infrastructure projects solely. However, the economic liberalization policy led to the private sector participation in infrastructure industries. Development and Merchant banks such as IDBI in India help fund these activities for the private sector.

**Trade development**

Trade is the most important economic activity. Both, domestic and international trade is supported by the financial system. Traders need finance which is provided by the financial institutions. Financial markets on the other hand help discount financial instruments such as promissory notes and bills. Commercial banks finance international trade through pre and post-shipment funding. Letters of credit are issued for importers, thereby helping the country to earn important foreign exchange.

**Employment growth**

Financial system plays a key role in employment growth in an economy. Businesses and industries are financed by the financial systems which lead to growth in employment and in turn increase economic activity and domestic trade. Increase in trade leads to increase in competition which leads to activities such as sales and marketing which further increases employment in these sectors.

**Venture capital**

Increase in venture capital or investment in ventures will boost growth in economy. Currently, the extent of venture capital in India is less. It is difficult for individual companies to invest in

ventures directly due to the risk involved. It is mostly the financial institutions that fund ventures. An increase in the number of financial institutions supporting ventures will boost this segment.

**Balances economic growth**

The growth of different sectors of an economy is balanced through the financial system. There are primary, secondary and tertiary sector industries and all need sufficient funds for growth. The financial system of the country funds these sectors and provides sufficient funds for each sector – industrial, agricultural and services.

## Reserve Bank of India (RBI)

Reserve Bank of India (RBI) is the central bank of India entrusted with a multidimensional role which includes implementation of monetary policy and maintaining monetary stability in the country. RBI was established on 1st April 1935 under the Reserve Bank of India Act, 1934. Initially, Reserve Bank of India was established as a private shareholders bank, but it was nationalized after independence in the year 1949 through the Reserve Bank (Transfer of public ownership) act, 1948.

As per the Preamble of Reserve Bank of India, the role and functions of RBI are described as to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth.

**Role and functions of RBI**

1. ***Traditional role and functions***

Traditional role and functions of RBI refer to those functions which every Central Bank of a country has to perform all over the world. Traditional functions are mainly the basic and fundamental functions of RBI.

- **Issue currency notes:** RBI has the sole authority to issue currency notes in India. Earlier all currency notes except one rupee note and coins of smaller denomination were issued by RBI. This system of issuing currency notes is known as minimum reserve system. The currency notes issued by RBI are a legal tender throughout the territory of India without any limitations. It issues these currency notes against the security of gold bullion, gold coins, promissory notes, exchange bills and government of India bonds etc.
- **Banker to other banks: Reserve Bank of India** is the apex monetary body in the country and it controls the volume of bank reserves. It helps and regulates other banks to create credit in the right proportion. It has obligatory powers to regulate, guide, help and direct other banks of the country, and hence it acts as the guardian of commercial banks in India..

- **Banker to the government:** Reserve Bank of India acts as the banker and agent to the government. RBI to conduct transactions on behalf of Central and state governments. It has the duty to make payments, taxes, and deposits on behalf of the government.
- **Foreign Exchange Management:** Reserve Bank of India has the responsibility to stabilize the external value of Indian currency. It keeps gold bullions and foreign currency reserves against currency note issue and has the responsibility to meet the adverse balance of payment with other nations.. It maintains this stability through buying and selling of foreign currency etc.
- **RBI as the bank of Central clearance, settlement, and transfer**: RBI provides the facility of clearing house for settling banking transactions. This allows other banks to settle their interbank claims smoothly and economically. This facility is provided by Reserve Bank of India through a cell called as the National Clearing Cell.
- **Credit control function:** RBI tries to maintain price stability in the country which is essential for economic development. It regulates money supply in the economy according to the changing circumstances of the economy. It uses various measures such as qualitative and quantitative techniques to regulate credit in the economy. It uses quantitative controls such as bank rate policy, cash reserve ratio, open market operations etc. Qualitative controls include selective credit control, rationing of credit etc.

2. ***Promotional and developmental Role and Functions***

Every Central Bank has to perform various promotional and development functions which vary from country to country. This is truer in a developing country like India were RBI has been performing the functions of the promoter of financial system along with several special functions.

- **Export promotion through refinance facility:** RBI promotes export through the Export Credit and Guarantee Corporation (ECGC) and EXIM Bank. It provides refinance facility for export credit given by the scheduled commercial banks.
- **Development of financial system:** RBI promotes and encourages the development of Financial Institutions, financial markets and the financial instruments which is necessary for the faster economic development of the country. It encourages all the banking and non-banking financial institutions to maintain a sound and healthy financial system.
- **Support for Industrial finance:** RBI supports industrial development and has taken several initiatives for its promotion. It has played an important role in the establishment of industrial finance institutions such as ICICI Limited, IDBI, SIDBI etc.
- **Support for the agricultural sector:** RBI provides financial facilities to the agricultural sector through NABARD and regional rural banks. RBI provides indirect financial assistance to NABARD by providing large amount of money through General Line of Credit at lower rates.

- **Training provision to banking staff:** RBI provides training to the staff of banking industry by setting up banker's training college at many places. Institutes like National Institute of Bank Management (NIBM), Bank Staff College (BSC) etc. provide training to the Banking staff.

3. **Supervisory Role and Functions**

RBI performs certain non-monetary functions for the supervision of banks and promotion of sound banking system in India. Supervisory functions ensure improvement in the methods of operation of Banking in India.

- **Giving license to banks:** RBI has the authority to grant license to the banks for carrying out business. It provides license for the opening of new branches, opening extension counters, and also for closing down existing branches.
- **Bank inspection and enquiry:** RBI can inspect loans and advances, deposits, investment functions etc. which helps to ensure that financial Institutions and banks carry out their operations in a proper manner. It carries out periodical inspection once or twice a year and banks have to take remedial measures pointed out during an inspection.
- **Implementation of deposit Insurance Scheme:** Under this scheme, deposits below Rs 1 lakh are insured with the Deposit Insurance Guarantee Corporation set up by Reserve Bank of India. It implements the deposit Insurance Scheme in case of failure of any Bank.
- **Periodic review of the working of commercial banks:** The supervisory function of RBI also includes periodic review of the working of commercial banks. It takes necessary steps to increase the efficiency of the commercial banks, and for the implementation of policy changes and schemes for the improvement of the banking system.

**Techniques of Monetary Policy of Reserve Bank of India (RBI)**

The **Monetary Policy** is a process whereby the monetary authority, generally the central bank controls or regulates the money supply in the economy. The monetary policy committee of RBI has the responsibility to fix the benchmark policy interest, also known as a repo rate for the controlling inflation rate. One of the major objectives of monetary policy is to contain inflation rate at 4%, with maximum standard deviation of 2%.

***Quantitative measures:***

- **Bank rate:** it is the interest rate at which RBI provides long term loan to commercial banks. The present bank rate is 4.25%. It controls the money supply in long term lending through this instrument. When RBI increases bank rate the interest rate charged by commercial banks also increases. This, in turn, reduces demand for credit in the economy. The reverse happens when RBI reduces the bank rate.

- **Repo rate:** Repo repurchase agreement rate is the interest rate at which the Reserve Bank provides short term loans to commercial banks against securities. At present, the repo rate is 4.00%.
- **Reverse repo rate:** It is the opposite of Repo, in which banks lend money to RBI by purchasing government securities and earn interest on that amount. Presently the reverse repo rate is 3.35%.
- **Marginal Standing Facility (MSF):** It was introduced in 2011-12 through which the commercial banks can borrow money from RBI by pledging government securities which are within the limits of the statutory liquidity ratio (SLR). Presently the Marginal Standing Facility rate is 4.25%.

- **Cash reserve ratio (CRR):** It is the minimum amount of cash that commercial banks have to maintain with the Reserve Bank of India in the form of deposits. An increase in CRR decreases money supply in the economy whereas a decrease in CRR increases the money supply. The current CRR rate is 3%.
- **Statutory liquidity ratio (SLR):** It is the minimum percentage of non-cash assets to be kept with RBI. It includes government securities, bonds, gold etc. An increase in SLR reduces the capacity of banks to give loans to its customers. The reverse happens when SLR is reduced. The current SLR rate is 18%.
- **Open market operations (OMOs):** open market operations include the sale and purchase of government securities for either injecting or absorbing liquidity from the economy.

**Qualitative Measures**

- **Fixation of Margin Requirement**: Banker lends money against price of securities. The amount of loan depends upon the margin requirements of the banker. The word margin here means the difference between the loan value and market value of securities. The central bank has the power to change the margins, which limits the amount of loan to be sanctioned by the commercial banks. As obvious, during inflation higher margin would be fixed while during deflation, lower margin would be fixed.
- **Regulation of consumer credit**: During inflation, this method is followed to control excess spending of the consumers. Generally the hire purchase facilities or installment methods are used to reduce to the minimum to curb the expenditure on consumption. On the contrary, during depression period, more credit facilities are allowed so that consumer may spend more and more to pull the economy out of depression.

- **Credit rationing**: It is a method of regulating and controlling purpose for which credit is guaranteed by the commercial bank. Under this method, the central bank controls credit by rationing it among its various uses. It also seeks to control the allocation of bank credit among the various categories of borrowers. The Reserve Bank has been authorised to secure distribution of credit in conformity with the national priorities. As required by the Central Government, the Reserve Bank has issued directives to the commercial banks that at least 40% of their credit must be disbursed among the priority sectors of the economy such as agriculture, small industries, artisans, education, housing, etc.
- **Moral suasion**: "Moral suasion" means persuasion of commercial banks to follow certain policies, impressing upon them the necessity to do. There is no legal compulsion in this regard by the Reserve Bank or Government of India and therefore the success of these measures depends upon the cooperation of the commercial banks. Through the instrument of Moral Suasion, the approach is informal rather than formal.
- **Issue of Directives:** To regulate the volume of bank loans the central bank may issue directives to the commercial banks from time to time. The directives may be in the form of oral or written statements or appeals or warnings. By means of these directives the RBI may decrease or increase the volume of credit.

## Unit 2 - Money and Capital Markets

### INDIAN MONEY MARKET

Money Market is a market where short term instruments that mature in a year or earlier are traded. Money market is a market for short-term financial assets which are near substitutes for money.

**Characteristics of Money Market**

- Short term funds are borrowed and lent.
- No fixed place for conduct of operations.
- Dealings may be conducting with or without the help of brokers.
- The short term financial assets that are dealt in are close substitutes of money.
- Funds are traded for a maximum period of one year.
- Presence of a large number of sub markets such as inter-bank call money, bills rediscounting, treasury bills etc.

**What are Money Market Instruments?**

1. Call/ Notice/ Term Money
2. Treasury Bills
3. Commercial Bills
4. Commercial Paper (CP)
5. Certificate of Deposit (CD)

**Call Money Market**

The call money market is an essential part of the Indian Money Market, where the day-to-day surplus funds (mostly of banks) are traded. The money market is a market for short-term financial assets that are close substitutes of money. The loans are of short-term duration varying from **1 to 14 days,** are traded in call money market. The money that is lent for one day in this market is known as **"Call Money",** and if it exceeds one day (but less than 15 days) it is referred to as **"Notice Money**". **Term Money** refers to Money lent for 15 days or more in the Inter Bank Market.

**Banks borrow in this money market for the following purpose:**

- To fill the gaps or temporary mismatches in funds
- To meet the Cash Reserve Ratio(CRR) & Statutory Liquidity Ratio(SLR) mandatory requirements as stipulated by the RBI
- To meet sudden demand for funds arising out of large outflows.
- Thus call money usually serves the role of equilibrating the short-term liquidity position of banks

**Treasury Bills**

When the government goes to the financial market to raise money, it does so by issuing two types of debt instruments — treasury bills and government bonds. Treasury bills are issued when the government needs money for a short period. These bills are issued only by the central government, and the interest on them is determined by market forces.

**What is Treasury Bills?**

Treasury Bills are money market instruments offered to finance short term debt obligation of the Government of India. Treasury Bill Market refers to bills or promissory notes issued at discount by RBI on behalf of Government of India to raise short term funds to meet government deficit requirements.

For example, Government issues a 91 days Treasury bill or Rs.1000 at a discount rate of 10%. You can invest on T-bills by paying Rs.900 and government will pay you at 1000/- after the expiry of 91 days.

**Types of T-Bills**

Treasury bills have a minimum maturity period of 14 days and maximum maturity period of 364 days. So, they are categorized as money market instruments. At present, treasury bills are issued in four maturities

1. 14 days T-Bill
2. 91-days T-Bill
3. 182-day T-Bill
4. 364-day. T-Bill

**Participants**

- RBI
- Commercial Banks
- State Government
- Primary Dealers
- Discount and Finance House of India
- Non Banking Financial Companies
- Corporate Companies
- Individuals

**Features**

1. T-Bills are available for minimum of Rs.25,000 and in multiples of Rs.25,000
2. T-Bills are negotiable Instruments
3. Treasury bills are usually auctioned (bidding) by RBI every week.
4. Issued by RBI on behalf of Government
5. Issued at Discount and redeemable at par on maturity
6. Highly Liquid Instrument
7. Risk free government securities

8. Assured Returns

**Advantages**

1. Higher Safety (Zero Risk)
2. Highly Liquid
3. Low Transaction Costs
4. Helpful to bank to maintain SLR and CRR
5. Helps to Government in raising short term funds
6. Tool for money supply
7. Helpful to non banking companies to meet their liabilities
8. Hedging against volatility in call money markets

**Dis-advantages**

1. Lower returns (fixed returns)
2. Absence of competitive bids
3. No Active Trading

**Commercial Bills**

A Commercial bill or Bills of exchange issued by a commercial organization to raise money for short-term needs.

Under section 5 of Indian Negotiable Instrument Act a bill means "An instrument in writing containing an unconditional order, signed by marker, directing a certain person to pay a certain sum of money only to, or order of a certain person, or to the bearer of instrument."

**Features of a Bill**

1. It must be in writing.
2. It must contain an order to pay.
3. Unconditional order.
4. It must be signed by drawer.
5. Parties to bill: drawer, drawee & payee.
6. Payment must be in money.
7. It must be payable on demand or otherwise.
8. Requires acceptance.
9. Must be stamped.
10. Self liquidating instrument.
11. Drawn for short period

**Types of Commercial Bills**

**A. According to time**

(a)Demand Bill or Sight Bill: a bill of exchange which is payable on demand or at sight.

(b)Time Bill or Usance Bill: a bill of exchange payable after the expiry of a fixed period is called a time bill or usance bill.

**B. According to place**

(a) Inland Bill: A bill of exchange which is drawn and payable in same country.

(b) Foreign Bill: A bill of exchange which is drawn in a foreign country and is payable in a foreign country.

**C. According to Objective or Usage**

(a) Trade Bill: A bill of exchange drawn in respect of trade transaction drawn by seller on buyer in respect of payment of price of goods sold.

(b) Accommodation Bill: A bill which is drawn or endorsed without receiving any value thereof.

- These bills are drawn to raise loans.
- They are drawn to accommodate another person and are not genuine bills.

**D. From viewpoint of payment or according to receiver**

(a) Bearer Bill: A bill of exchange which is payable to any person who presents it for payment.

(b) Order Bill: A bill which is payable to a certain person named in the bill or his order. Not payable to bearer.

**Commercial Paper**

A Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. With a view to enable highly rated corporate borrowers to diversify their sources of short-term borrowing and also provide an additional instrument to investors, RBI introduced Commercial Papers as a money market instrument in the Indian financial market in 1990.

**Issuers**

- Corporates,
- primary dealers (PDs) and
- the All-India Financial Institutions (FIs)

**Eligibility**

A corporate would 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 crores

b) company has been sanctioned working capital limit by bank/s or all-India financial institution/s; and

c) the borrower account of the company is classified as a Standard Asset by the financing bank/s/ institution/s.

**Maturity Period**

CP can be issued for maturities between **a minimum of 7 days and a maximum of up to one year** from the date of issue. .

**Minimum Amount**

CP can be issued in denominations of Rs.5 lakhs or multiples thereof.

**Open Subscription**

The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription.

**Issuing and Paying Agent (IPA)**

Every issuer must appoint an IPA for issuance of CP. The issuer should disclose to the potential investors its financial position as per the standard market practice. Only a scheduled bank can act as an IPA for issuance of CP.

**Issued at a discount**

CP will be issued at a discount to face value as may be determined by the issuer.

**Participants**

Individuals, banking companies, other corporate bodies (registered or incorporated in India) and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs) etc. can invest in CPs.

Features of Commercial Paper

Few distinct features are:

- It is a short-term money market tool, including a *promissory note* and a set maturity.
- It acts as an evidence certificate of unsecured debt.
- It is subscribed at a discount rate and can be issued in an interest-bearing application.
- The issuer guarantees the buyer to pay a fixed amount in future in terms of liquid cash and no assets.
- A company can directly issue the paper to investors, or it can be done through banks/dealer banks.

**Advantages of Commercial Paper**

- **Contributes Funds –** It contributes extra funds as the cost of the paper to the issuing company is cheaper than the loans of the commercial bank.
- **Flexible** – It has a high liquidity value and flexible maturity range giving it extra flexibility.
- **Reliable** – It is highly reliable and does not have any limiting condition.
- **Save Money –** On commercial paper, companies can save extra cash and earn a good return.
- **Lasting Source of Funds**– Maturity range can be customised according to the firm’s requirement, and matured papers can be paid by selling the new commercial paper.

**LIMITATIONS OF COMMERCIAL PAPER**

- As the commercial papers are unsecured they can be issued by only highly rated firms having a good past record of profitability . New companies cannot issue commercial papers.
- The size of the issue of the commercial papers is limited to the extent that the liquidity available at a particular time should be in excess of the required working capital of the company.
- The commercial papers are issued for a fixed maturity period which cannot be extended. So, if a company gets into a financial difficulty, it cannot extend the maturity period and the redemption has to be made whenever due.

**Certificate of Deposit**

Certificate of Deposit or CD is a fixed-income financial instrument governed under the Reserve Bank and India (RBI) issued in a dematerialized form. The amount at payout is assured from the beginning. A CD can be issued by any All-India Financial Institution or Scheduled Commercial Bank. They are issued at a discount provided on face value. Like a fixed deposit (FD), a CD's purpose is to denote in writing that you have deposited money in a bank for a fixed period and that bank will pay you interest on it based on the amount and duration of your deposit.

**Features of CD**

- CDs can be issued in India for a minimum deposit of ₹1 lakh and in subsequent multiples of it.
- Scheduled Commercial Banks (SCBs) and All-India Financial Institutions are eligible to issue a CD. Cooperative Banks and RRBs cannot issue a CD.
- CDs issued by SCBs have in term period anywhere between 3 months to a year.
- CDs issued by financial institutions have a term period ranging from 1–3 years.
- Similar to dematerialized securities, CDs in dematerialized forms are transferable through means of endorsement or delivery.
- There is no lock-in required for a CD.
- One cannot issue a loan against a CD.
- A certificate of deposit is fully taxable under the Income Tax Act.
- A CD cannot be publicly traded.
- Banks are not permitted to buy back a CD before its maturity.

**Advantages of Issuing CD in India**

**Security:**

A certificate of deposit or FD is not going to eat up your capital due to market volatility. It is a completely secure financial instrument with an assured sum at maturity, similar to traditional insurance. The money you put into your CD will continue to predictably increase and there is no risk of any loss. It is a very secure short to mid-term investment.

**High-Interest Rate:**

This benefit is what attracts most investors towards a CD. They offer larger rates of interest which can go as high as 7.8% on the lump sum deposited than traditional savings accounts whose interest rates average around 4%.

**Flexibility:**

You can opt for monthly payouts, annual payouts, or a lump sum withdrawal of your CD at maturity. You can pick the duration and price you want to invest, although it has to fit certain parameters set by the bank. Tailoring the CD to your needs helps you get the most from it.

**Low to Minimum Maintenance Costs:**

When it comes to the market there are always brokerage costs for the delivery, buying and selling of shares. There are usually no additional costs associated with a CD. You only pay what you invest with some banks.

## SEBI REGULATIONS

SEBI(Securities and Exchange Board of India) was constituted on April 12,1988 as a non-statutory body. It is an apex body to develop and regulate the stock market in India. SEBI is the regulator for the securities market in India, originally set up by the Government of India in 1988; it acquired statutory form in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI now has Statutory powers with regards to regulation of the Securities and Commodities market in India. The Head office of SEBI is in Mumbai and regional offices at Kolkata (East), Ahmedabad (West), New Delhi (North) and Chennai (South). It also has local offices in almost all major cities of the country.

**OBJECTIVES**

1. To protect the interest of investors and ensure safety of their investments
2. To promote the development of securities market – Investor education
3. To prevent fraudulent and unfair trade practices
4. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, merchant bankers
5. To regulate the securities market

**SCOPE OF SEBI**

The scope of operations of SEBI is very wide. It can frame or issue rules, regulations, directives, guidelines, norms in respect of both the primary and secondary markets, intermediaries operating in these markets and certain financial institutions.

**Role of SEBI**

SEBI acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment for the financial market enthusiasts that facilitate efficient and smooth working of the securities market. It ensures that the three main participants of the financial market are taken care of, i.e. issuers of securities, investor, and financial intermediaries.

**Issuers of securities**

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

**Investors**

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

**Financial Intermediaries**

These are the people who act as middlemen between the issuers and investors. They make the financial transactions smooth and safe. Intermediaries such as brokers, underwriters, merchant bankers etc.,

**FUNCTIONS**

There are mainly two types of functions. They are;

1. Regulatory Functions
2. Developmental Functions

**1. Regulatory Functions**

a) Regulation of stock exchange and self regulatory organizations.
b) Registration and regulation of stock brokers, sub-brokers, registrar to all issue, merchant bankers, underwriters, portfolio managers and such other intermediaries who are associated with securities market.
c) Registration and regulation of the working of collective investment schemes including mutual funds.
d) Prohibition of fraudulent and unfair trade practices relating to securities market.
e) Prohibition of insider trading in securities.
f) Regulating substantial acquisitions of shares and takeover of companies.

**2. Developmental Functions**

a) Promoting investor's education.
b) Training of intermediaries.
c) Conducting research and published information useful to all market participants.
d) Promotion of fair practices. Code of conduct for self- regulatory organizations.
e) Promoting self-regulatory organizations.

**PROCESS OF I.P.O. (INITIAL PUBLIC OFFER)**

A Company proposing to raise resources by a public issue should first select the type of securities i.e. share and /or debentures to be issued by it. The decision regarding the issue of shares to be made at par or premium should be decided keeping in view the SEBI guidelines.

The various steps involved in public issue of shares are enumerated below:

1. **Compliance With The SEBI Guidelines**

Before making any issue of capital, it is to be ensured that the proposed issue complies with the provision of the SEBI guideline for disclosure and investor protection with regards to Pricing of issue, promoters, Contribution, lock in period, reservation, etc.

2. **Intimation To Stock Exchange**

   A copy of the Memorandum and Articles of Association of the company is to be sent to the Stock Exchanges where the shares are to be listed, for approval.

3. **Appointment**

   A Company, which issues shares, has to appoint one or more Merchant Bankers, who act as Lead Managers to the public issue. The company may, also appoint Registrars, underwriter, brokers etc

4. **Drafting of Prospectus**

   Apart from the notice of offer to issue shares to public prospectus should also disclose:

   - Justification of Premium, if called.
   - Net Asset value (NAV )
   - High and Low price of the shares of the company for the last two years.
   - Highlights of the issue, as well as the "Risk Factors".
   - A clause that company shall refund the entire application money if minimum subscription is not received.

5. **Approval of Prospectus**

   The draft prospectus along with the application form for issue of shares should be approved by the solicitors/legal advisors/stock exchange & [where application has been made seeking permission for shares to be draft in] of the company to ensure that it contains all disclosures and information as required by various statutes, rules, notifications, etc. After the concerned parties / agencies have approved the draft prospectus and the application form, the board of directors of the company should approve the final draft, before filing with the Registrar of companies.

6. **Registration of Prospectus With Roc**

   Before the prospectus is issued to the public it must be filed with the Registrar of companies, duly signed thereon by every director or proposed director of the company. The prospectus must be registered with ROC within 3 months of vetting by SEBI.

7. **Application to Stock Exchange to List Shares**

   Before filing prospectus with the Registrar of companies, the company should submit on application to the Stock Exchange (s) for enlistment of securities offered to the public by the said issue. The fact that an application has / have been made to the stock exchange must be stated in the prospectus.

8. **Printing and Distribution of Prospectus and Application Forms**

   After Receipt of Acknowledgement card from the SEBI and the intimation from Registrar

of Companies regarding registration of prospectus, the company should take steps to issue the prospectus within 90 days of it's registration with ROC

9. **Announcement and Advertisement**

   Announcement regarding the proposed issue should be made at least ten (10) days before the subscription list opens. As stipulated by SEBI guidelines the subscription list for public issue is to be kept open for at least 3 working days and for a total period of not exceeding 10 working days, which is to be disclosed in prospectus as well.

10. **Separate Bank Account**

    A SEPARATE Bank account is opened for the purpose of collecting the proceeds of the issue. Further, the date of opening and closing of the subscription list should be intimated to all the collecting and controlling branches of the bank with whom the company has entered into an agreement for the collection of application forms.

11. **Minimum Subscription**

    As per the SEBI guidelines, if the company does not receive 90% of the issue amount from the public subscription including development from underwriters within 120 days from the date of the issue, the amount of subscription received is required to be refunded to the applications. In case of disputed development also, subscription is required to be refunded if 90% of the issued amount plus accepted

12. **Allotment of Shares**

    In case, the issue is over-subscribed, the basis of allotment has to be decided in consultation with the stock exchange authorities as per the guidelines laid down by the stock exchanges. The Over-subscribed amount should after the finalization of allotment, be refunded to the applicants within 10 weeks of the closure of subscription list.

13. **Compliance Report**

    As stipulated by SEBI guidelines within 45 days of the closure of issue, a report in the prescribed form along with a compliance certificate from statutory auditor/ practicing charted accountant or by a company secretary in practice is to be forwarded to SEBI by the lead managers.

14. **Issuance of Share Certificates**

    As per section 113, the company should deliver the share certificate within 3 months after the allotment of shares.

**Stock Market**

A Stock market is a place where one can trade different types of securities over a certain exchange.

There are primarily two types of security markets:

1. Primary market:

   It is the first market space for any company that wants to go public from private. This means any company that wants to sell its security in exchange for money to the public

for the first time. This is a market place, where the company issues IPO (initial public offering) to raise funds, to fund their new project or to raise additional funds for any ongoing projects. Such issues come to the market, individuals buy directly from the issuing company. This market is also termed as new issues market because it deals in new issues of securities.

2. Secondary Market:

   Secondary Market deals with securities which have already been issued and are owned by investors, both individual and institutional. This is a market where all the existing securities in the market are traded. The buying and selling of securities already issued and outstanding take place in stock exchanges. Stock exchanges constitute the secondary market in securities. The actual trading of a company's shares occurs in the secondary share market.

Stock exchange is a platform where dealings take place in shares, debentures, and bonds issued by the public sector companies, private enterprises and government etc. In other words, it can be said that stock exchange means an organized market where various securities i.e. shares, debentures, and bonds issued by companies, government organizations and semi-government organizations are sold and purchased. Stock exchange is also known as Security Market or Stock Market or Share Market. It is an organized market for the purchase and sale of industrial and financial securities. It is convenient place where trading in securities is conducted in systematic manner. The main object of establishing a stock exchange is to assist, to regulate and to control the buying and selling in securities. In other words, a stock exchange is a form of exchange which provides services for stock brokers and traders to trade shares, debentures and other securities. Stock exchanges also provide facilities for issue and redemption of securities.

**FEATURES OF STOCK EXCHANGE**

The main features of a stock exchange are as under:-

- Stock exchange is an organized market. It is run by an association, organization or body of individuals.
- It deals in securities issued by various concerns such as companies, government and other authorized authorities.
- The area of operation of a stock exchange is well defined.
- It is also called securities market or stock market.
- The main object of establishing a stock exchange is to assist, to regulate and to control the business in securities.
- It operates as per guidelines and rules issued by Securities and Exchange Board of India (SEBI).

**FUNCTIONS OF STOCK EXCHANGE**

The main functions performed by a stock exchange are as under:-

- Stock Exchange provides a ready market for the shares, debentures, and bonds issued by various concerns.
- It helps in determining the price of various securities i.e. shares, debentures, and bonds.
- It helps in mobilization of surplus funds of cooperatives, business firms, and individuals for investment in popular securities.
- It plays a vital role in ensuring wider participation of ownership.
- It contributes to Economic Growth.
- It ensures fair dealings and safety of funds.
- It facilitates capital formation in the country by providing avenue for investment in various securities which yield higher return.

**ROLE OF STOCK EXCHANGES**

Role of Stock Exchanges are diverse and highly important in the development of economy of a country. They gauge and manage the growth of a country. Stock exchanges apart from being center of primary and secondary market, they have very important role to play in the economic growth of the country. Some of them are as follows:-

1. Raising capital for businesses:
   Stock Exchanges help joint stock companies to capitalize by selling shares to the investing public.
2. Mobilizing savings for investment:-
   They help investing public to mobilize their savings to invest in high yielding sectors of economy, which results in higher yield, both to the individual and to the nation.
3. Facilitating company expansion:
   They help joint stock companies to spread out and grow by acquisition or fusion.
4. Profit sharing:
   They help stock investors, to get their share in the wealth of profitable businesses.
5. Corporate governance:
   They impose severe rules to get listed in them. Therefore, listed public companies have better management records than privately held companies.
6. Creating investment opportunities for small investors
   By buying a small number of shares, small investors can also participate in the growth of large companies.
7. Government capital rising for development projects:
   Through the issue of bonds, they help government to rise fund for developmental activities. An investor who buys them will be lending money to the government, which is safer (secure), and sometimes enjoys tax benefits also.
8. Barometer of the economy
   They maintain the stock indices which are the indicators of the general trend in the economy. They also regulate the price fluctuations in stock.

**FINANCIAL DERIVATIVE MARKETS**

The term 'Derivative' stands for a contract whose price is derived from or is dependent upon an underlying asset. The underlying asset could be a financial asset such as currency, stock and market index, an interest bearing security or a physical commodity. As Derivatives are merely contracts between two or more parties, anything like weather data or amount of rain can be used as underlying assets.

**What are Derivative Instruments?**

A derivative is an instrument whose value is derived from the value of one or more underlying, which can be commodities, precious metals, currency, bonds, stocks, stocks indices, etc. Four most common examples of derivative instruments are Forwards, Futures, Options and Swaps.

**Types of Derivatives Instruments**

There are generally considered to be 4 types of derivatives: forward, futures, swaps, and options.

**Forward Contract**

A forward contract is a customized contract between two parties, where settlement takes place on a specific date in future at a price agreed today. The main features of forward contracts are:

- They are bilateral contracts and hence exposed to counter-party risk.
- Each contract is custom designed, and hence is unique in terms of contract size, expiration date and the asset type and quality.
- The contract price is generally not available in public domain.
- The contract has to be settled by delivery of the asset on expiration date.
- In case the party wishes to reverse the contract, it has to compulsorily go to the same counter party, which being in a monopoly situation can command the price it wants.

***Futures Contract***

Futures are exchange-traded contracts to sell or buy financial instruments or physical commodities for a future delivery at an agreed price. There is an agreement to buy or sell a specified quantity of financial instrument commodity in a designated future month at a price agreed upon by the buyer and seller. To make trading possible, BSE specifies certain standardized features of the contract.

**Swap Contract**

The derivative in which, counterparties exchange certain benefits of one party's financial instrument for those of the other party's financial instrument. The types of Swaps are:

- Interest rate swaps
- Currency swaps
- Commodity swaps

- Equity Swap
- Credit default swaps

***Options Contract***

An options contract gives the buyer the right, but not the obligation, to buy or sell something at a specific price on or before a specific date. With a forward contract, the buyer and seller are obligated to make the transaction on the specified date, whereas with options, the buyer has the choice to execute their option and buy the asset at the specified price.

**Participants**

1) **Hedgers** use futures or options markets to reduce or eliminate the risk associated with price of an asset.
2) **Speculators** use futures and options contracts to get extra leverage in betting on future movements in the price of an asset.
3) **Arbitrageurs** are in business to take advantage of a discrepancy between prices in two different markets.

**Use of Derivatives:**

Derivative contracts like futures and options trade freely on exchanges and can be employed to satisfy a variety of needs which includes the following-

**a) Hedge your securities**

The derivative contracts can be used to hedge your securities from price fluctuations. The shares which you possess can be protected on the downside by entering into a derivative contract. It also protects you from the rise in share price which you plan to purchase.

**b) Transfer of risk**

This is the most important use of derivative which helps in transferring risk from risk-averse people to a risk-seeking investor.

The risk-seeking investor can enter into a risky contrarian trades to gain short-term profits.

While the risk-averse investor, can enhance the safety of their position by entering into a derivative contract.

**c) Benefit from arbitrage opportunities**

Arbitrage trading simply means buying low in one market and selling high in another market. So with the help of derivative contracts, you can take advantage of price differences in two markets. Thus it helps in creating market efficiency.

## Unit 3 – The Banking and Non-banking Institutions

A bank is a financial institution which performs the deposit and lending function. A bank allows a person with excess money (Saver) to deposit his money in the bank and earns an interest rate. Similarly, the bank lends to a person who needs money (investor/borrower) at an interest rate. Thus, the banks act as an intermediary between the saver and the borrower.

**PUBLIC SECTOR BANKS**

Public sector banks are those which are owned and controlled by the government. In India the nationalized banks and regional rural banks come under this category. These public sector banks are developed in 4 phases, first the imperial bankof India was nationalized and it was named as the state bank of India in 1955. Later on 8 former state associated banks were re-constituted into 7 subsidiary banks of SBI. These banks are now called associated banks of SBI. Recently these banks are merged with SBI.On 19th -July-1969 14 major commercial banks were nationalized. Again on 15-april-1980 6 more commercial banks were nationalized. Another important development in public sector was the establishment of regional rural banks in 1974.

Public sector banks have either the government of India or reserve bank of India as the majority shareholder. The government/public banks are

1. Allahabad bank.
2. Andhra bank.
3. Bank of Baroda. -------------------- (Vijaya Bank &Dena Bank Merged into Bank of Baroda)
4. Bank of Maharashtra.
5. Canarabank. ------------------------ (Syndicate Bank Merged into Canara Bank)
6. Central bank of India.
7. Corporation bank.
8. Indian bank. ------------------------- (Allahabad Bank Merged into Indian Bank)
9. Indian overseas bank.
10. Oriental bank of commerce.
11. Bank of India.
12. Punjab and Sind bank.
13. Punjab national bank. -------------- (Oriental bank of commerce & United bank of India Merged into PNB)
14. Syndicate bank.
15. UCO bank.
16. United bank of India.
17. Union bank. -------------------------- (Andhra Bank & Corporation Bank Merged into Union Bank of India)
18. IDBI.
19. State Bank of India.

**PRIVATE SECTOR BANKS**

These banks are owned by the private individuals or corporations and not by the government or co-operative societies. The Narasimhan committee in its first report recommended the freedom of entry into the financial system. It started that the reserve bank of India should permit the establishment ofnew banks in the private sector provided they conform to the minimum start-up capital and other requirements.

At present there are 20 private sector banks in India,

1. City union bank ltd.
2. Dhanalakshmi bank ltd.
3. Federal bank ltd.
4. catholic Syrian bank ltd.
5. Karnataka bank ltd.
6. Karurvysya bank ltd.
7. Lakshmi vilas bank ltd.
8. Nainital bank ltd.
9. South Indian bank ltd.
10. Tamilnadu mercantile bank ltd.
11. YES bank ltd.
12. Axis bank ltd.
13. Kotak bank ltd.
14. ICICI bank ltd.
15. HDFC bank ltd.
16. IndusInd bank ltd.
17. DCB bank ltd.
18. Bhandan bank ltd.
19. RBL bank ltd.
20. United western bank ltd

## Commercial Banks

A **commercial bank** is a type of bank that provides services such as accepting deposits, making business loans, and offering basic investment products that is operated as a business for profit.

**Types of Commercial Bank**

Commercial banks are classified into two categories i.e. **scheduled commercial banks** and **non-scheduled commercial banks**. Further, scheduled commercial banks are further classified into three types:

- **Private Bank**: When the private individuals own more than 51% of the share capital, then that banking company is a private one. However, these banks are publicly listed companies in a recognized exchange.

- **Public Bank**: When the Government holds more than 51% of the share capital of a publicly listed banking company, then that bank is called as Public sector bank.
- **Foreign Bank**: Banks set up in foreign countries, and operate their branches in the home country are called as foreign banks.

Non-scheduled commercial banks refer to the banks which are not covered in the Reserve Bank of India’s second schedule. The paid-up capital of such banks is not more than Rs. 5 lakhs.

**Role of Commercial Banks**

A modern bank plays a significant and crucial role in economic development of a country. In the past bankers used to be mere dealers of money. Today, they are playing the role of a leader of economic growth. Bankers render distinct services to all types of customers.

Banks, by their ability of creation of credit, have placed at the disposal of the nations large sums of money. Economic significance of banks can be analyzed as follows:

1) **Facilitates the development of trade and industry**
   The multifarious growth of trade and industrial sector in the modern economy is possible only if there is timely availability of finance in required quantities. Banks provide different types of loans to encourage new entrepreneurs and give financial help to the existing industrialists’ to diversify and develop their industrial activity. Thus, the growth and development of industry and trade is mostly facilitated by banks.
2) **Facilitating the development of agriculture sector**
   Agriculture plays vital role in economic development of third world countries. But the development of this sector suffered from paucity of funds. Banks help agriculture and its allied activities like poultry, fisheries, and piggery, etc., by providing finances and technical consultancy
3) **Facilitating the development of service sector**
   Banks also provide finance for various services like transport, education, etc., thereby contributing to the strengthening of the infrastructure of the economy.
4) **Contributes for the balanced growth**
   Banks identify the nature, the scale and the location of industries needing special care. This helps in balanced growth of the economy. Banks also identify the backward regions. By providing finances to those industrial units which contribute to the growth of these backward areas, banks help in balanced regional development as well as balanced growth of the economy as a whole.
5) **Encouragement for international trade**
   By extending credit facilities for exports and imports and providing necessary information and data on international trade, banks encourage international flow of goods and services.
6) **Social service**

Banks also help in fulfilling various social needs like helping the needy and poor by introducing various schemes like self-employment, village adoption, educational assistance, slum removal programmes, etc.

7) **Implementation of monetary policy**

Sound economic development needs appropriate monetary policy. Well developed banking system helps the economy by implementing the monetary policy formulated by the central bank of the country.

**FUNCTIONS OF COMMERCIAL BANKS**

The functions of bank are divided into two types:

1. **Primary Functions**

   Initially, Collection of deposits and granting of Loans and advances used to be the primary functions of a Commercial bank. However, in modem economies creation of credit and foreign exchange dealings are also treated as primary functions of a bank.

   a) **Collection of Deposits**

   The most important primary functions of a commercial bank is collection of deposits. These deposits may be in the form of I ) fixed deposits, 2) savings bank deposits, 3) current deposits, and 4) recurring deposits

   b) **Loans and Advances**

   Normally commercial banks grant short-term loans and advances to: 1) business and trade, 2) industry, 3) agriculture and allied activities, and 4) export and import trade.

2. **Secondary Functions**

   For the convenience of customers, banks also perform a host of non-banking functions called secondary functions. These functions can be divided into two categories: (a) agency services, and (b) public utility services.

   a) **Agency Services**

   Various functions performed by a banker as an agent on behalf of the customer are called agency services. These agency services include: collection of cheques / drafts, payments, sale and purchase of securities, trustee, executor and attorney, and correspondence.

   b) **General Services**

   In addition to agency services, commercial banks perform various services useful to the customer. These services include Debit Card, Credit Card, online banking services, letters of credit, draft facilities, underwriting, Bank Guarantee for deferred payments, locker facilities, and foreign exchange dealings.

## Co-operative Banks

*"Cooperative Bank is an institution established on cooperative basis which deals in ordinary banking business for the promotion of economic, social and moral development of its members on the principle of equality."*

Cooperatives Banks are registered under the Cooperative Societies Act, 1912. These are regulated by the Reserve Bank of India and National Bank for Agriculture and Rural

Development (NABARD) under the Banking Regulation Act, 1949 and Banking Laws (Application to Cooperative Societies) Act, 1965.

**Characteristics of Cooperative Bank**

Some of the main features or characteristics of cooperative banks are:

**Customer-owned entities**

The members of cooperative banks are both the owners and the customers of the bank. Thus, the aim of the cooperative bank is not to maximize profits but to provide the best possible services to its members. Some of the cooperative banks also admit non-members so as to provide them with banking services.

**Democratic member control**

Cooperative banks are owned and controlled by members, who democratically elect the board of directors. The basic principle of co-operatives "one man one vote" is followed, irrespective of the number of shares held by a member, which ensures that no member enjoys any arbitrary power over other members.

**Profit allocation**

A specified portion of the profits are transferred to Statutory Reserve and other reserves, and then a fair rate of interest is paid on the capital subscribed by the members. A part of this profit can also be distributed to the co-operative members, with legal and statutory limitations in most cases.

**Inclusion of rural masses**

It plays a significant role in the financial inclusion of unbanked rural masses.

**Functions of Cooperative Banks**

- It provides financial assistance to people with small means and protects them from the dominance of money lenders providing loans and other services at a higher rate at the expense of the needy.
- It supervises and guides affiliated societies.
- Rural financing- It provides financing to rural sectors like cattle farming, crop farming, hatching, etc. at comparatively lower rates.
- Urban financing- it provides financing for small scale industries, personal finance, home finance, etc.
- It mobilises funds from its members and provides interest on the invested capital.
- They provide funds and services to small borrowers and small business.

## Non-banking Financial Institutions

**Definition of Non-banking Finance Company**

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares, securities, leasing, hire-purchase, insurance business, and chit business.

**Different types of NBFCs**

NBFCs provide range of financial services to their clients. Types of services under non-banking finance services include the following:

1. Hire Purchase Services
2. Leasing Services
3. Housing Finance Services
4. Asset Management Services
5. Venture Capital Services

**Role and Functions of Various NBFCs**

**Hire Purchase Services**

Hire purchase is the legal term for a conditional sale contract with an intention to finance consumers towards vehicles, white goods etc. If a buyer cannot afford to pay the price as a lump sum but can afford to pay a percentage as a deposit, the contract allows the buyer to hire the goods for a monthly rent. If the buyer defaults in paying the installments, the owner can repossess the goods. HP is a different form of credit system among other unsecured consumer credit systems and benefits. Hero Honda Motor Finance Co., Bajaj Auto Finance Company is some of the HP financing companies.

**Leasing Services**

A lease or tenancy is a contract that transfers the right to possess specific property. Leasing service includes the leasing of assets to other companies either on operating lease or finance lease. An NBFC may obtain license to commence leasing services subject to, they shall not hold, deal or trade in real estate business and shall not fix the period of lease for less than 3 years in the case of any finance lease agreement except in case of computers and other IT accessories. First Century Leasing Company Ltd., Sundaram Finance Ltd. is some of the Leasing companies in India.

**Housing Finance Services**

Housing Finance Services means financial services related to development and construction of residential and commercial properties. An Housing Finance Company approved by the National Housing Bank may undertake the services /activities such as Providing long term finance for the purpose of constructing, purchasing or renovating any property, Managing public or private sector projects in the housing and urban development sector and Financing against existing property by way of mortgage. ICICI Home Finance Ltd., LIC Housing Finance Co. Ltd., HDFC is some of the housing finance companies in our country.

**Asset Management Company**

Asset Management Company is managing and investing the pooled funds of retail investors in securities in line with the stated investment objectives and provides more diversification, liquidity, and professional management service to the individual investors. Mutual Funds are comes under this category. Most of the financial institutions having their subsidiaries as Asset Management Company like SBI, BOB, UTI and many others.

**Venture Capital Companies**

Venture capital Finance is a unique form of financing activity that is undertaken on the belief of high-risk-high-return. Venture capitalists invest in those risky projects or companies (ventures) that have success potential and could promise sufficient return to justify such gamble. Venture capitalist not only provides finance but also often provides managerial or

technical expertise to venture projects. In India, venture capital concentrate on seed capital finance for high technology and for research & development. ICICI ventures and Gujarat Venture are one of the first venture capital organizations in India and SIDBI, IDBI and others also promoting venture capital finance activities.

**Mutual Funds**

A Mutual fund is an investment tool that allows small investors to access a well diversified portfolio of equities, bonds and other securities. Each shareholder participates in the gain or loss of the fund. Units are issued and can be redeemed as needed. A mutual fund is a professionally managed firm of collective investments that pools money from many investors and invests it in stocks, bonds, short-term money market instruments, and/or other securities.

A mutual fund is an investment vehicle where many investors pool their money to earn returns on their capital over a period. This corpus of funds is managed by an investment professional known as a fund manager or portfolio manager. It is his/her job to invest the corpus in different securities such as bonds, stocks, gold and other assets and seek to provide potential returns. The gains (or losses) on the investment are shared collectively by the investors in proportion to their contribution to the fund.

Why invest in mutual funds

There are many benefits of investing in mutual funds. Here are some important ones -

1. **Professional expertise**

   But if you don't have the skill or the time to delve deep into the market, investing in mutual funds can be an excellent alternative. Here, a professional fund manager takes care of your investments and strives hard to provide reasonable returns. And just as you would pay the driver for his chauffeuring services, you have to pay specific fees for the professional management of your mutual fund investments.

2. **Returns**

   one of the biggest mutual fund benefits is that you have the opportunity to earn potentially higher returns than traditional investment options offering assured returns. This is because the returns on mutual funds are linked to the market's performance. So, if the market is on a bull run and it does exceedingly well, the impact would be reflected in the value of your fund. However, a poor performance in the market could negatively impact your investments. Unlike traditional investments, mutual funds do not assure capital protection. So do your research and invest in funds that can help you meet your financial goals at the right time in life.

3. **Diversification**

   You may have heard the saying: Don't put all your eggs in one basket. This is a famous mantra to remember when you invest your money. When you invest only in a single asset, you could risk a loss if the market crashes. However, you can avoid this problem by investing in different asset classes and diversifying your portfolio.
   If you were investing in stocks and had to diversify, you would have to select at least ten stocks carefully from different sectors. This can be a lengthy, time-consuming process.

But when you invest in mutual funds, you achieve diversification instantly. For instance, if you invest in a mutual fund that tracks the BSE Sensex, you would get access to as many as 30 stocks across sectors in a single fund. This could reduce your risk to a large extent.

4. **Tax benefits**

   Mutual fund investors can claim a tax deduction of up to Rs. 1.5 lakh by investing in Equity Linked Savings Schemes (ELSS). This tax benefit is eligible under Section 80C of the Income Tax Act. ELSS funds come with a lock-in period of 3 years. Hence, if you invest in ELSS funds, you can only withdraw your money after the lock-in period ends..

**Insurance Companies**

**Types of Insurance**

1. **Life Insurance**
2. **General Insurance**

**1. Life Insurance**

Life Insurance refers to a policy or cover whereby the policyholder can ensure financial freedom for his/her family members after death. Suppose you are the sole earning member in your family, supporting your spouse and children.

In such an event, your death would financially devastate the whole family. Life insurance policies ensure that such a thing does not happen by providing financial assistance to your family in the event of your passing.

**Types of Life Insurance Policies**

There are primarily seven different types of insurance policies when it comes to life insurance. These are:

- **Term Plan** - The death benefit from a term plan is only available for a specified period, for instance, 40 years from the date of policy purchase.
- **Endowment Plan** - Endowment plans are life insurance policies where a portion of your premiums go toward the death benefit, while the remaining is invested by the insurance provider. Maturity benefits, death benefit and periodic bonuses are some types of assistance from endowment policies.
- **Unit Linked Insurance Plans or ULIPs** - Similar to endowment plans, a part of your insurance premiums go toward mutual fund investments, while the remaining goes toward the death benefit.
- **Whole Life Insurance** - As the name suggests, such policies offer life cover for the whole life of an individual, instead of a specified term. Some insurers may restrict the whole life insurance tenure to 100 years.
- **Child’s Plan** - Investment cum insurance policy, which provides financial aid for your children throughout their lives. The death benefit is available as a lump-sum payment after the death of parents.
- **Money-Back** - Such policies pay a certain percentage of the plan’s sum assured after regular intervals. This is known as survival benefit.

- **Retirement Plan** - Also known as pension plans, these policies are a fusion of investment and insurance. A portion of the premiums goes toward creating a retirement corpus for the policyholder. This is available as a lump-sum or monthly payment after the policyholder retires.

**Benefits of Life Insurance**

If you possess a life insurance plan, you can enjoy the following advantages from the policy.

- **Tax Benefits** - If you pay life insurance premiums, you are eligible for tax benefits in India, under Section 80(C) and 10(10D) of the Income Tax Act. Thus, you can save a substantial sum of money as taxes by opting for a life insurance plan.
- **Encourages Saving Habit** - Since you need to pay policy premiums, buying such an insurance policy promotes the habit of saving money.
- **Secures Family's Financial Future** - The policy ensures your family's financial independence is maintained even after your demise.
- **Helps Plan Your Retirement** - Certain life insurance policies also act as investment options. For instance, pension plans offer a lump-sum payout as soon as you retires, helping you to fund your retirement.

**2. General Insurance**

**Motor Insurance**

Motor insurance refers to policies that offer financial assistance in the event of accidents involving your car or bike. Motor insurance can be availed for three categories of motorised vehicles, including:

- **Car Insurance** - Personally owned four-wheeler vehicles are covered under such a policy.
- **Two-wheeler Insurance** - Personally owned two-wheeler vehicles, including bikes and scooters, are covered under these plans.
- **Commercial Vehicle Insurance** - If you own a vehicle that is used commercially, you need to avail insurance for the same. These policies ensure that your business automobiles stay in the best of shapes, reducing losses significantly.

**Health Insurance**

Health insurance refers to a type of general insurance, which provides financial assistance to policyholders when they are admitted to hospitals for treatment. Additionally, some plans also cover the cost of treatment undertaken at home, prior to a hospitalisation or after discharge from the same.

With the rising medical inflation in India, buying health insurance has become a necessity. However, before proceeding with your purchase, consider the various types of health insurance plans available in India.

**Benefits of Health Insurance**

After assessing the various kinds of health insurance available, you must be wondering why availing such a plan is essential for you and your loved ones. Look at the reasons listed below to understand why.

- **Medical Cover** - The primary benefit of such insurance is that it offers financial coverage against medical expenditure.
- **Cashless Claim** - If you seek treatment at one of the hospitals that have tie-ups with your insurance provider, you can avail cashless claim benefit. This feature ensures that all medical bills are directly settled between your insurer and hospital.
- **Tax Benefits** - Those who pay health insurance premiums can enjoy income tax benefits. Under Section 80D of the Income Tax Act one can avail a tax benefit of up to Rs.1 Lakh on the premium payment of their health insurance policies.

There may be additional advantages, depending on the insurance provider in question.

**Travel Insurance**

When talking about the different types of insurance policies, one must not forget to learn more about travel insurance plans. Such policies ensure the financial safety of a traveller during a trip. Therefore, when compared to other insurance policies, travel insurance is a short-term cover.

Depending on the provider you choose, travel insurance may offer financial aid at various times, such as during loss of baggage, trip cancellation and much more. Here is a look at some of the different types of travel insurance plans available in the country:

**Benefits of Travel Insurance**

The following aspects are covered under travel insurance plans:

- **Cover Flight Delay** - Flight delays or cancellations can lead to significant losses for the passenger. If you buy travel insurance, you can claim such financial losses from the insurer.
- **Baggage Loss/Delay** - Travel insurance lets you claim monetary assistance if there is a delay or you happen to lose your luggage during the trip. With this amount, you can purchase some of the necessary items.
- **Reclaim Lost Travel Documents** - Visa and passport are essential documents during an international trip. Opting for international travel insurance ensures that you have the necessary financial backing to reapply for interim or replacement documents as and when necessary.
- **Trip Cancellation Cover** - A sudden death in the family or a medical emergency may play spoilsport with your travel arrangements. Thankfully, international travel insurance plans support trip cancellations in such events. You can claim financial assistance to pay penalties and cancellation charges for flights, hotels, etc.

**Property Insurance**

Any building or immovable structure can be insured through property insurance plans. This can be either your residence or commercial space. If any damage befalls such a property,

you can claim financial assistance from the insurance provider. Keep in mind that such a plan also financially safeguards the content inside the property.

**Benefits of Property Insurance**

If you still think that property cover is not one of the types of insurance plans you need to avail, take a look at some of the advantages from the same.

- **Protection against Fires** - While the insurance policy cannot prevent fires, it can prevent financial liabilities from such an event.
- **Burglaries** - If your property exists in an area prone to theft and burglaries, such a policy is vital to ensure financial security.
- **Floods** - In certain parts of India, floods are common. These floods can ravage your property leading to substantial losses. Property insurance also protects against such events.
- **Natural Calamities** - The plan also offers financial aid against damage arising from earthquakes, storms and more.

Rebuilding or renovation of a property is immensely expensive. Thus, property insurance policies are the best option to ensure long-term financial health.

## UNIT 4 – FINANCIAL SERVICES (FUND BASED)

### Leasing

Leasing is a contract between two parties. The leasing company called Lessor and the user called Lessee. The lessor arranges to buy capital equipment for the use of the lessee foran agreed period of time in return for the payment called rent.

Lease is a contract whereby the owner of the asset(lesser) grants to another party(lessee), the exclusive right to use the asset usually for an agreed period of time in written for the payment of rent.

### Rights, Obligations and Responsibilities of the Lessor

- Obligation of acquiring the lease asset according to the lessee's specification.
- Right of ownership of the leased asset.
- Right to claim depreciation on the asset.
- Right to ensure that the asset is put to fair use and within the limitations contained in the agreement.
- Right to recover the rentals and other sums payable by the lessee under the agreement.
- Right to sue in case of conversion of the asset by the lessee.
- Right to terminate the lease contract in case of misuse of leased goods by the lessee or if the lessee does not pay the lease rentals.
- Right to reimbursement of damages in case of misuse of leased assets.
- Right to the recovery of the leased asset in the event of the lessee's failure to pay the lease rentals or lessee's bankruptcy
- Responsibility towards the lessee for legal deficiencies of the leased asset and responsibility towards the lessee for suffered damages in this respect.

### Rights, Obligations and Responsibilities of the Lessee

- Obligation to pay the lease rentals periodically as specified in the lease agreement.
- Obligation to keep the asset insured at all times for an amount equal to the full insurable value of the asset.
- Obligation to return the leased asset to the lessor upon expiration or earlier termination of this lease agreement.
- Right to use and operate the asset during the lease period, according to the terms of the lease agreement.
- Right to terminate the financial lease contract if the asset has not been delivered in line with the contract (not deliver the asset, delivers the asset with delay or material deficiency).
- Right of damage compensation and termination of the lease rental payment until the delivery of the leased asset is in line with the lease contract.

- Responsibility for the damage caused by using the lease asset.
- Responsibility for a sudden devastation or damage of the leased asset from the moment of taking over the asset.

**Types of Leases**

1. **Financial Lease**

   Financial lease is also known as Capital lease—a means of financing capital equipments. A financial lease is a lease that transfers substantially all the risks and rewards incident to the ownership of an asset to the lesse, though the lessor is the legal owner in substance. Title may or may not eventually be transferred. It is the alternative to own funds, bank credit and borrowing, through the issue of debt securities. According to AS-19, whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. In financial lease, the asset is leased for a long period. Generally, the time duration is equal to the economic life of the asset.

2. **Operating Lease**

   A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Both AS19 as well as IAS17 define operating lease as a lease other than a finance lease. An operating lease is a lease in which the period of lease is short when compared to the useful life of the asset or the equipment being leased. An operating lease is mostly used to acquire assets on a relatively short period basis. For instance, an aircraft which has an economic life of 25 years may be leased to an airline for 5 years on an operating lease. The lease period being short, the lessor will recover the cost of the asset from multiple lessees. They are typically for assets like computers, windmills and so on. In operating lease, the lessor is responsible for all kinds of maintenance, insurance and all other expenses related to the leased asset.

3. **Sale and Leaseback**

   In this type of lease, the owner of an asset sells that asset to the lessor and then gets the asset back on lease from the lessor. The purpose of the leaseback is to free up the original owner's capital while allowing the owner to retain possession and use of the property. A sale and leaseback can be beneficial to both the buyer as well as the seller. The seller gets a lumpsum of cash quickly which improves the liquidity. And the lessor gets the benefit in terms of tax credit and a flow of regular income.

4. **Leverage Leasing**

   Under leveraged leasing arrangement, a third party is involved besides the lessor and the lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party, that is, the lender and the asset so purchased is held as a security against the loan. The lender is paid off from the lease rentals directly by the lessee and

the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset, is entitled to a depreciation allowance, associated with the asset.

5. **Close and Open ended Lease**
   In a close ended lease, the asset gets transferred to the lessor, at the end of the lease - contract period, where as in an open ended lease, the lessee has the option of purchasing the asset.
6. **Percentage Lease**
   In the percentage lease, the lessor needs to pay fixlease rentals plus some percentage of the previous year's gross revenue.
7. **Cross-border Lease**
   In the cross-border or international lease, the lessee and the lessor are situated in two different countries.

**Advantages of Leasing**

1. No large outlay
   Leasing could provide 100% financing as the lessor buys the equipment and leases to the lessee. The lessee need not make large cash payments for the purchase of the needed equipment. It finances a higher percentage of the price of the leased asset when compared to a bank loan.
2. Tax Advantages
   Under a finance lease, the lessor gets the benefit of tax depreciation. Lease rentals are considered as an operating cost, which means that it is possible to deduct them from taxable profits (as a trading expense). As lease rentals are fully tax deductible, the cost of the asset is written-off in the lessee's books over the lease period.
3. Budgeting
   As a lease agreement is almost always a fixed contract, it is relatively easy to budget and forecast with. The amount can be worked into business budgets much more easily and allowing to keep a much better control over the current and future cash flow.
4. Hedge against risk of obsolescence
   In an operating lease, the obsolescence risk is borne by the lessor. Likewise, the lessee is saved of the trouble of having to dispose of the asset that he is not using—by simply terminating the contract or returning it to the lessor.

**Disadvantages of Leasing**

1. No ownership
2. Long-term expense
3. Cost of maintenance
4. Restrictions on use of equipment

5. Termination of the contract in case of default

**Hire Purchase**

Hire purchase agreement is a contract whereby the owner of the goods (hire seller) lets them on hire to hire purchaser on payment of rent, to be paid in installments and the title in the goods will pass to the hirer on the payment of last installment.

**Features of Hire Purchase System**

1. Possession: The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.
2. Installments : The goods are delivered by the hire vendor on the condition that the hire purchaser should pay the amount in periodical installments
3. Down Payment: the hire purchaser generally makes a down payment after signing the agreement.
4. Components of Hire purchase Installments: Each installment consist of two elements – Finance charge (interest) and Principal amount.
5. Ownership : Ownership is transferred to the hirer on payment of last installment
6. Repossession: In case of default in respect of payment of installment, the hire vendor has the right to take the goods back without making any compensation.

| Point of Difference | Leasing | Hire-Purchase |
|---|---|---|
| Ownership | Ownership is not transferred to the lessee. | Ownership is transferred to the hirer on payment of last installment |
| Tax Deductibility | The entire lease rental is a tax deductible for the lessee | Only the interest component is tax-deductible expense for the hirer. |
| Depreciation and other allowances | Cannot be claimed by the lessee. | Can be claimed by the hirer |
| Salvage Value | The lessee, not being the owner of the asset, does not enjoy the salvage value of the asset | The hirer, being the owner of the asset, enjoys the salvage value of the asset |

**Factoring**

Factoring may be defined as an agreement between the financial institution and the business concern that is selling the goods on credit.

Factoring is the process of selling invoices to a company in return for funds in advance. The factor records, collects and protects the book debts and purchases the bills of receivable of the seller.

Factoring is an arrangement in which a financial intermediary called "Factor" collects the account receivables on behalf of the seller of the goods or services.

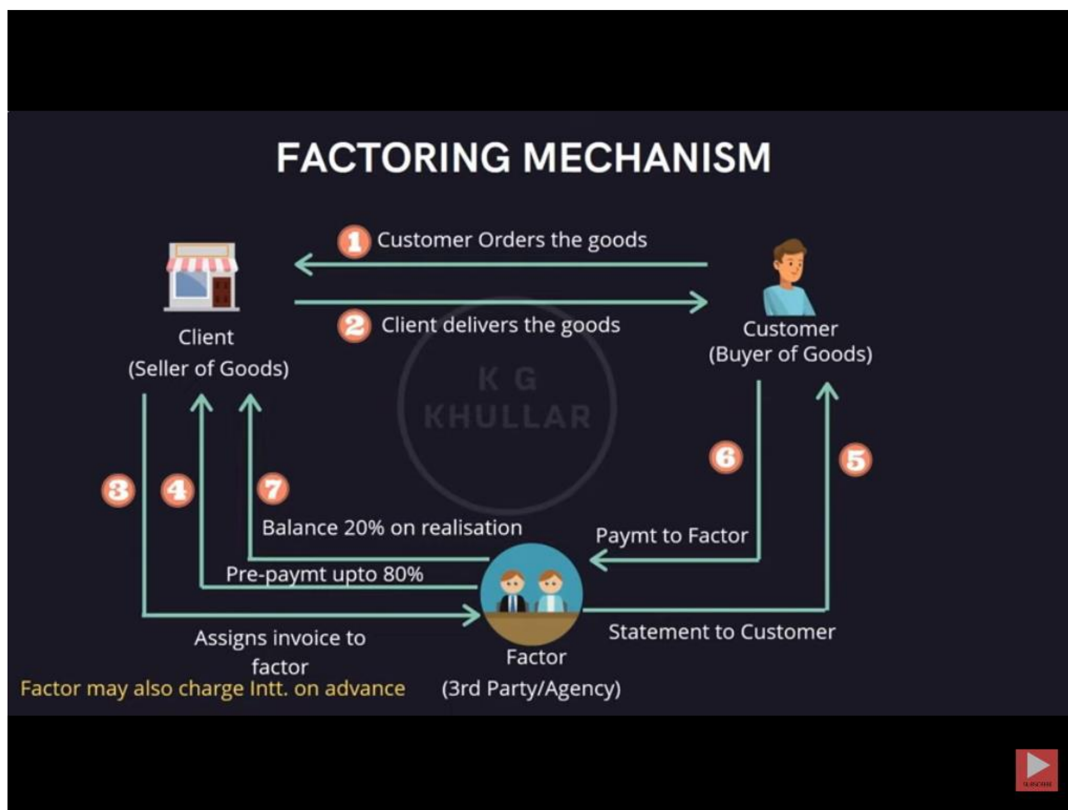
**Why Factoring?**

Factoring helps the seller to sell goods on credit and provides immediate funds to the seller. It provides liquidity to the seller. It also minimizes the bad debts and functions as effective financial services to their clients.

**Parties to Factoring Contract**

1. Customer (Buyer of goods)
2. Client ( Seller of goods)
3. Factor (Financial intermediary or 3rd Party Agent)

**Factoring Mechanism or Procedure**




The mechanism of factoring can be explained with the help of the following flowchart.

1. Customer places an order with the client for goods and/or service on credit;
2. Client delivers the goods and sends invoice to customers.

3. Client assigns invoice to factor.
4. Factor makes prepayment upto 80 per cent and sends periodical statements.
5. Monthly statement of accounts to customer and follow-up.
6. Customer makes payment to factor.
7. Factor makes balance 20 per cent payment on realization to the client.

**Types of Factoring**

1. Recourse Factoring
   In Recourse Factoring, Any bad debts losses are borne by the client firm itself.
2. Non-Recourse Factoring or Full Factoring
   In Non-Recourse Factoring, Any loss arising from bad debts will be borne by the factor only.
3. Maturity Factoring
   Under maturity factoring no advance payment is made by the factor but payment is made only on the guaranteed payment date or on the date of collection. Maturity factoring is also known as collection factoring.
4. Advance Factoring
   Under Advance factoring, the factor makes an arrangement pays a pre-specified portion of the account receivables in advance to the client on submission of necessary documents. This type of arrangement is known as advance factoring. The balance portion is paid upon collection or on the guaranteed payment date. Generally, factoring is advance factoring and factor pays 80 per cent of the invoice amount in advance.

**Advantages of Factoring**

1. It provides liquidity to the business concern that sells goods on credit.
2. It minimizes labor cost as the factor records, collects and controls the book debts.
3. Factoring provides Credit Services such as credit screening and monitoring, early detection of customer service.
4. Factoring reduces bad debts through timely collections on invoices.
5. It allows the business to increase credit sales and expand business.
6. It helps the seller to concentrate on sales without worrying about bad debts.
7. It provides liquidity to supplier. This money of the seller is not locked up in business due to credit transaction.
8. Factoring companies offer a degree of credit management, saving time and resources in managing the debtors.
9. It allows the seller to sell goods on credit.

**Venture Capital**

Venture capital is financing that investors provide to start-up companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banks and any other financial institutions.

Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long term growth potential.

**Features of Venture Capital investments**

1. High Degrees of Risk

   Venture capital represents financial investment in a highly risky project with the objective of earning a high rate of return.
2. Equity Participation

   Venture capital financing is an actual or potential equity participation wherein the objective of venture capitalist is to make capital gain by selling the shares once the firm becomes profitable.
3. Long Term Investment

   Venture capital financing is a long term investment. It generally takes a long period to encash the investment in securities made by the venture capitalists.
4. Participation in Management

   In addition to providing capital, venture capital funds take an active interest in the management of the assisted firms. Thus, the approach of venture capital firms is different from that of a traditional lender or banker. It has been rightly said, "venture capital combines the qualities of banker, stock market investor and entrepreneur in one".
5. Achieve Social Objectives

   Venture capital projects generate employment, and balanced regional growth indirectly due to setting up of successful new business.
6. Lack of Liquidity

   A venture capital is not subject to repayment on demand as with an overdraft or following a loan repayment schedule. The investment is realised only when the company is sold or achieves a stock market listing. It is lost when the company goes into liquidation.

**Methods or Modes of Finance by Venture Capitalists**

Venture capitalists provide funds for long-term in any of the following modes

1. Equity - Most of the venture capital funds provide financial support to entrepreneurs in the form of equity by financing 49% of the total equity. This is to ensure that the ownership and overall control remains with the entrepreneur.

2. Conditional loan - From a venture capitalist~ point of view, equity is an unsecured instrument and hence a less preferable option than a secured debt instrument. A conditional loan usually involves either no interest at all or a coupon payment at nominal rate. In addition, a royalty at agreed rates is payable to the lender on the sales turnover.
3. Convertible loans - The convertible loan is subordinate to all other loans, which may be converted into equity if interest payments are not made within agreed time limit.

**Stages of Investment Financing**

"Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability." Venture capital firms usually recognise the following two main stages when the investment could be made in a venture namely:

A. Early Stage Financing

i. Seed Capital & Research and Development Projects.
ii. Start Ups
iii. Second Round Finance

B. Later Stage Financing

i. Development Capital
ii. Expansion Finance
iii. Replacement Capital
iv. Turn Arounds
v. Buy Outs

Advantages

1. They bring wealth and expertise to the company
2. Large amount of equity finance
3. Encourage new breed of entrepreneurs to take up risk
4. No obligation to pay the money
5. Provide valuable information and managerial assistance
6. Technical advice
7. Economic growth
8. Share risks and rewards

Dis-advantages

1. Lost autonomy and control
2. Lengthy and complex process
3. Uncertain form of financing
4. Benefits in long run only

**Housing finance**

Housing finance is a broad topic, the concept of which can vary across continents, regions and countries, particularly in terms of the areas it covers. ... "The purpose of a housing finance system is to provide the funds which home-buyers need to purchase their homes.

Housing industry consists of Formal or Organised and Informal or unorganized sector. Organised sector is operated by the apex body National Housing Bank (NHB), a subsidiary of RBI. The beginning of formal housing finance in India first came with the setting up of HUDCO in 1971.

**Need for housing finance**

The housing finance sector has a tremendous development impact both in terms of providingsocial stability and in promoting economic development.

1. Social stability: Housing finance contributes to social stability by enabling households to purchase an asset which will represent their largest single investment.
2. Economic development: Investing in housing accounts for 15% to 35% of aggregate investment worldwide. By supporting housing finance sectors the entrepreneurs (finance companies) can invest in small business. Housing constructing and housing related sectors constitute approximately 9% of the labour force worldwide

**Major institutions and banks involved in housing finance:**

Institutions involved in housing finance are as follows—

1. HUDCO (Housing and Urban Development in Housing Finance).
2. LICHFL (LIC Housing Finance Limited).
3. GICHFL (GIC Housing Finance Limited).
4. DHFL (Dewan Housing Finance Corporation Limited).
5. CFHL (Can Fin Homes Limited).

**HUDCO (Housing and Urban Development in Housing Finance).**

The Housing and Urban Development Corporation Limited (HUDCO) is a government-owned corporation in India. One of the public sector undertakings (PSU), it is wholly owned by the Union Government and is under the administrative control of the Ministry of Housing and Urban Poverty Alleviation.

This institution came into existence on 25, April, 1970 as a private limited company under the complete ownership of Indian Government with an equity base of Rs. 2 crores under the Companies Act, 1956.

The organisation provides finance for setting up of new towns and also works as consultancy services for the projects of designing and planning relating to Housing and Urban Development programs in India as well as abroad. It also provides loans for Road and Transport, Solid Waste Management, sewerageand Drainage and Water Supply.

**LICHFL (LIC Housing Finance Limited).**

LIC Housing Finance Limited (LIC HFL) is one of the largest Housing Finance companies in India having its Registered and Corporate office at Mumbai. The main objective of the Company is to provide long term finance to individuals for purchase or construction of house or flat for residential purpose / repair and renovation of existing flat / houses. The Company also provides finance on existing property for business / personal needs and also gives loans to professionals for purchase / construction of Clinics / Nursing Homes / Diagnostic Centres / Office Space and also for purchase of equipment's. The Company also provides long term finance to persons engaged in the business of construction of houses or flats for residential purpose and to be sold by them.

LICHFL Incorporated on 19 June 1989 under the Companies Act, 1956,

**GICHFL (GIC Housing Finance Limited).**

GIC Housing Finance Ltd is a subsidiary of General Insurance Corporation of India.The company is engaged in the housing finance activity The companyalso has tie-ups with corporates for various housing finance needs.GIC Housing Finance Ltd was incorporated on December 12, 1989 with the name GIC GrihVitta Ltd.

**DHFL (Dewan Housing Finance Corporation Limited).**

Dewan Housing Finance Corporation Ltd. (DHFL) is a deposit-taking housing finance company, headquartered in Mumbai with branches in major cities across India. DHFL was established to enable access to affordable housing finance to the lower and middle income groups in semi-urban and rural parts of India. DHFL is the second housing finance company to be established in the country. The company also leases commercial and residential premises. DHFL is among the 50 biggest financial companies in India.

DHFL was established and incorporated by Rajesh Kumar Wadhawan on 11 April 1984. The name of the company was changed to Dewan Housing Development Finance Ltd. and later to Dewan Housing Finance Corporation.

**CFHL (Can Fin Homes Limited).**

CanFin Homes Ltd, set up under the sponsorship of Canara Bank, was incorporated in the year 1987, "The International Year of Shelter for the Homeless". The main objective of setting up the company was, promoting home ownership and as well, increasing the housing stock in the country. It is the first housing company to be promoted by a nationalized bank in India.

CanFin Homes Ltd is one of the top players in the housing finance sector, in the country today. The company has completed 29 successful years of operation in the field of home finance and has a renowned history of making profits and paying dividends continuously, since inception in 1987.

**Banks Involved in Housing Finance—**

- Scheduled Commercial Banks.
- Regional Rural Banks (RRB's).
- Agriculture and Rural Development Banks.
- Housing Development Finance Corporation Limited (HDFC).

Each and every bank has its own rules and regulations to give housing loans for the customers in the market some Regional Rural Banks will give loans for cheap rates for the people in rural areas to develop the farmers and normal rate house loans will be given to urban customers. The bank will follow the rules of interest rate which is given by the Reserve Bank of India.

## UNIT 5 – FINANCIAL SERVICES (FEE-BASED)

Fee based financial services do not create immediate funds the creation of funds through their services for which they charge a fee. These services include the business of issue management either by making arrangement regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management. Fee based services are as follows.

- STOCK BROKING
- CREDIT RATING.
- MERCHANT BANKING.
- PORTFOLIO SERVICES.
- UNDERWRITING.
- DEPOSITORY SERVICES

## STOCK BROKING

A stockbroker is a middleman who has the authority to buy and sell stocks and securities in a stock exchange on the investor's behalf

Stocks are traded through exchanges. However, an investor cannot directly trade in stock exchanges. To buy a stock or sell a stock through exchanges, you need an intermediary who will help you with the transaction. This middleman can be a person or a company who is authorised to buy and sell stocks and other securities on your behalf. Such a person or a company is known as a stockbroker. Stockbrokers are generally associated with a stockbroking firm, but they can also be an independent person. For providing this service, a stockbroker charges a commission or a fee.

**Services of Stock Brokers**

1. Stockbrokers give accurate advice on buying and selling stocks and other securities. Since they know the markets, they can advise a client on what stocks to buy and sell and when to buy or sell them. They thoroughly research securities before making such recommendations
2. Stockbrokers buy and sell shares on behalf of their clients and handle the associated paperwork. They also act as a record keeper and keep records of all transactions, statements and so on
3. Stockbrokers manage the client's investment portfolio and provide regular updates to their clients about their portfolios. They also answer investment questions that a client may have
4. Stockbrokers inform their client about any new investment opportunity in the stock market

5. Stockbroker also helps a client to make changes in investment strategies depending on the market conditions

**How are they regulated?**

Stockbrokers are governed under the Securities and Exchange Board of India Act 1992, Securities Contract Regulations Act, 1956, and also the Securities and Exchange Board of India (Stockbrokers and sub-brokers Regulations), 1992. Stockbrokers are also regulated under other rules, regulations and bylaws that SEBI may issue from time to time. Every stockbroker in India needs to be a member of stock exchanges and also requires to be registered with SEBI. Stockbrokers display their registration details on their websites and even on official documents. One can also visit the SEBI website and find details of registered stockbrokers.

**Types of stockbrokers**

Based on types of service provided, there are two types of stockbrokers- full-service stockbroker and a discount stockbroker.

**Full-service stockbrokers:** Full-service stockbrokers offer a full stack of services to its clients. They are traditional brokers who provide a trading facility coupled with advisory services. For this reason, the fees charged by full-service stockbrokers are high, and the brokerage they charge is based on the total amount of trades that are executed by the client. Full-service brokerages are established players who have branches located all over the country. Clients can visit these branches for service and advice.

**Discount stockbrokers:** Discount stockbrokers have come into existence due to the increased use and availability of the Internet. These brokers provide an online trading platform for their clients. However, discount brokers do not offer advisory services and research facilities. For this reason, discount brokers also charge fewer commissions, which is mostly a flat fee.

All brokerages now provide services online where a customer can log in with a username and password and execute trades. Online stockbroking services are faster since transactions can be done with the help of the Internet, and the broker can also connect with the client through chat rooms, emails and provide real-time updates.

When knowing what is a stockbroker, it is also essential to understand the meaning of a sub-broker. A sub-broker is a person or agent who is appointed by brokers to act on their behalf. A sub-broker is not a member of the stock exchange. Sub brokers need to register with SEBI without which they do not have the permission to deal in securities.

## CREDIT RATING

A credit rating agency is an entity which assesses the ability and willingness s of the issuer company for timely payment of interest and principal on a debt instrument.

Credit rating agencies are agencies which provide ratings to represent objective analyses and independent assessments of companies, entities or countries that issue such debt securities. These ratings are an indication to the buyers of this debt how likely they are to be paid back

**What are These Ratings?**

A credit rating issued by a rating agency is an assessment of the creditworthiness of securities issued by corporations, governments and other entities. The ratings given to such securities are mostly represented as AAA, AAB, Ba3, CCC etc. It is very similar to a marking system wherein the highest rating AAA is given to a borrower who has the highest probability of paying back. In that way, AAA is considered to be one of the safest debt securities to buy.

**Role of Credit Ratings in Capital Markets**

There are four entities that are impacted by a debt instrument:

1. The investor
2. The issuer
3. The financial intermediaries
4. The regulator

Credit ratings offer benefits to all these parties. Here is the importance of credit rating agencies in the capital markets.

**1. Benefits of Credit Ratings to Investors**

Investors use credit ratings to make investment decisions. They derive the following benefits from them:

- **Assistance in decision-making** – A quick look at the credit rating of an instrument tells investors about the risks associated with it. This allows them to choose instruments based on their risk tolerance and expected returns.
- **Regular reviews of ratings** – Credit rating agencies regularly review the ratings to ensure that it is relevant to the existing condition of the issuer and market. Hence, if an investor has purchased an instrument with the highest rating but finds it to be downgraded, then he can decide to sell the instrument to curb his losses.
- **Assurance of safety** – An instrument with a high credit rating assures investors of the safety of their investment and the financial strength of the issuer.
- **Ease of understanding** – Credit rating agencies have a standard way of rating instruments. Hence, investors can easily understand the investment proposal.
- **Saves time & effort** – Analyzing an issuing company's financial strength can take a lot of effort and time and requires some financial competence too. However, the credit rating provided by these professional agencies ensures that all the important factors are taken into consideration. Hence, investors can rely on these ratings and save a lot of time and effort.

**2. Benefits of Credit Ratings to Issuers**

The issuing company derives the following benefits from credit ratings:

- **Creates corporate image** – For an issuing company, it's better to have a corporate image based on facts as opposed to perception. Credit ratings ensure that the company gets a true corporate image in the market.
- **Can reduce the cost of borrowing** – If a company has low risk according to the credit rating agency, then it will give it a high credit rating. This means that investors will buy debt instruments from the company if they are looking at low-risk investments and will willingly accept lower interest rates. Hence, the issuing company can raise capital at a lower cost.
- **More avenues for borrowing** – If a company has a good credit rating, then there is no shortage of avenues to approach for raising funds. This is because most organizations offering financing options accept credit ratings provided by recognized agencies.
- **Helps promote non-popular companies** – Many companies are not popular among investors. Hence, when they issue a debt instrument, the reach is limited since investors are not aware of them. However, if a company has a high credit rating, then investors will invest in them even if they have never heard their names before.

**3. Benefits of Credit Ratings to Financial Intermediaries**

The financial intermediaries derive the following benefits from credit ratings:

- **No need to explain the risk/return of a debt instrument** – Credit ratings are self-explanatory and easy to understand. If an investor looks at an instrument with an AAA rating, he expects lower interest rates and purchases it if his risk tolerance is low. Hence, stockbrokers and other financial intermediaries don't have to explain risks or returns to their clients.
- **Reduces dependency** – Investors can choose instruments based on their investment plan by looking at the credit rating of various instruments. This allows them to be independent and reduces the load on investment advisors.

**4. Benefits of Credit Ratings to Regulators**

- The regulators derive the following benefits from credit ratings:
- **Increases transparency** – Credit rating agencies use all possible information on the issuing company (quantitative and qualitative) to assign a credit rating to it. This includes information that is not easily available to regular investors. Hence, it makes the process of investing in such instruments more transparent.
- **Creates a differentiation between companies** – Credit ratings allow regulators to easily differentiate between performing and non-performing companies without additional effort or cost.
- **Timely action** – Credit ratings allow regulators to take timely action against defaulting companies.

**Core Functions**

Compiling financial data essential for loan decisions and insurance.

1. Statistical assessment that is involved in ascribing a rating to a borrower.
2. Providing investors an objective analysis of the organization's ability to pay back.

**Credit Rating Agencies in India**

There are a number of credit rating agencies in India, out of which the three main rating agencies are as follows-

**1. CRISIL**

CRISIL commenced its operations in the year 1987 and it is India's first credit rating agency. The company conducts its operations from 8 countries including India, US, UK, Singapore, China, Poland, Argentina and Hong Kong. However, it has its head office in Mumbai.

The company provides ratings, analytics, and solutions, research with a very good track record of innovation and growth. Standard and Poor's is the majority shareholder of CRISIL.

The long-term ratings given by CRISIL are shown below-

| Rating scale for Long-Term Instruments | |
|---|---|
| CRISIL AAA (Highest Safety) | Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk. |
| CRISIL AA (High Safety) | Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk. |
| CRISIL A (Adequate Safety) | Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. |
| CRISIL BBB (Moderate Safety) | Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk. |
| CRISIL BB (Moderate Risk) | Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. |
| CRISIL B (High Risk) | Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations. |
| CRISIL C (Very High Risk) | Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations. |
| CRISIL D Default | Instruments with this rating are in default or are expected to be in default soon. |

**2. ICRA**

ICRA was the second rating agency established in the year 1991. It is a public limited company and it has its head office in New Delhi. Moody's is the majority shareholder of ICRA. The long-term rating of ICRA is exactly similar to CRISIL as shown in the chart above.

**3. CARE**

Then in the year 1993, the next credit rating agency which came up was CARE. It has its head office in Mumbai and it is India's second largest credit rating agency.

It is one of the five partners of international rating agency called ARC Ratings.

## Merchant Banking

**Definition of Merchant Banker**

A merchant banker can be defined as "An organization that acts as an intermediary between the issuers and the ultimate purchasers of securities in the primary security market." A merchant banker is an institution that helps companies to raise capital. It is an organization that underwrites corporate securities, provides advisory services to its clients.

**Meaning of Merchant Banker**

A merchant bank is a financial institution which provides capital to companies in the form of share ownership instead of loans. A merchant bank also provides advisory on corporate matters to the firms they lend to. Both commercial banks and investment banks may engage in merchant banking activities.

**Merchant Banking in India**

Merchant banking services strengthen the economic development of a country as they acts as sources of funds and information for corporations. Considering the way the Indian economy is growing, the role of merchant banking services in India is indispensable. These financial institutes also act as corporate advisory bodies to help corporations rightly get involved in various financial activities.

**Public Sector Merchant Bankers**

- SBI capital markets ltd
- Punjab National bank
- Bank of Maharashtra
- IFCI financial services ltd

**Private Sector Merchant Bankers**

- ICICI Securities Ltd
- Axis Bank Ltd
- Bajaj Capital Ltd
- Tata Capital Markets Ltd ·

- ICICI Bank Ltd ·
- Reliance Securities Limited
- Kotak Mahindra Capital Company Ltd ·
- Yes Bank Ltd.

**Foreign Players in Merchant Banking**

- Goldman Sachs (India) Securities Pvt. Ltd
- Morgan Stanley India Company Pvt. Ltd
- Barclays Securities (India) Pvt. Ltd
- Bank Of America
- Deutsche Equities India Private Limited
- Citigroup Global Markets India Pvt. Ltd

**Merchant Bank Services**

1) Project Counseling

   Project counseling comprises preparation of project reports, deciding upon the financing pattern to finance the cost of the project and appraising the project report with the financial institutions and banks. It also includes filling up of application forms with significant information for obtaining funds from financial institutions and obtaining government approval.

2) Management of Debt and Equity offerings

   This is the major function of the merchant banker. They assist the companies in raise funds from the market. The main areas of work in this regard include; Instrument designing, Pricing the issue, Registration of the offer document, Underwriting support, Marketing of the issue, Allotment and refund, Listing on stock exchanges.

3) Issue Management

   Management of issue involves marketing of corporate securities like equity shares, preference shares and debentures or bonds by offering them to public. Merchant banks act as an intermediary to transfer capital from those who own it to those who need it. After taking action as per SEBI guidelines, the merchant banker organizes a meeting with company representatives and advertising agents to finalize arrangements relating to date of opening and closing of issue, registration of prospectus, launching publicity campaign and fixing date of board meeting to approve and sign prospectus and pass the necessary resolutions. Pricing of issues is done by the companies in consultant with the merchant bankers.

4) Design of Capital Structure

   Capital Structure of a firm has to be distinguished from financial structure. Capital structure is financed by long term sources which consist of debt and equity. On the other hand, a financial structure which includes all forms debt and equity covers all financial resources. These include short term as well as long–term sources.

5) Managers, Consultants or Advisers to the Issue

The managers to the issue assist in the drafting of prospectus, application forms and completion of formalities under the Companies Act, appointment of Registrar for dealing with share applications and transfer and listing of shares of the company on the stock exchange. Companies can appoint one or more agencies as managers to the issue.

6) Underwriting of Public Issue

Underwriting is a guarantee given by the underwriter that in the occurrence of under subscription, the amount underwritten would be subscribed by him. Banks/Merchant banking institutions cannot underwrite more than 15% of any issue.

7) Portfolio Management

Portfolio indicates investment in different types of securities such as shares, debentures or bonds issued by different companies. Portfolio management means maintaining proper combinations of securities in a mode that they give maximum return with minimum risk.

8) Restructuring Strategies

A merger is a blending of two companies into a single company where one survives and other loses its corporate existence. A takeover is the purchase by one company obtaining controlling interest in the share capital of another existing company. Merchant bankers act as the middlemen in setting negotiation between the two companies. Merchant bankers assist the management of the client company to successfully restructure various activities such as mergers and acquisitions, divestitures, management buyouts, joint venture among others.

9) Loan Syndication

Loan syndication is an assistance provided by merchant bankers to get mainly term loans for projects. Such loans may be obtained from a single development finance institution or a syndicate or consortium. Merchant bankers help corporate clients to raise syndicated loans from banks and other financial institutions.

10) Corporate Counseling and Advisory Services

Corporate counseling involves the entire field of merchant banking activities such as project counseling, capital restructuring, public issue management, loan syndication, working capital, fixed deposit, lease financing acceptance credit, etc. Merchant bankers also provide customized solutions to their client's financial problems. Apart from this they also explore the refinancing alternatives of the client, and evaluate cheaper sources of funds. Rehabilitation and turnaround management is another area of advice. A merchant banker advises the client on different hedging strategies and suggests the appropriate strategy.

11) Placement and Distribution

The merchant banker helps in distributing different securities like equity shares, debt instruments, mutual fund products, fixed deposits, insurance products, commercial paper, etc. The distribution network of the merchant banker can be classified as institutional and retail in character. The institutional network consists of mutual funds, foreign institutional investors, private equity funds, pension funds, financial institutions etc. The size of such a network signifies the wholesale reach of the merchant banker. The retail network is purely depends on networking with investors.

**Depository Services**

In order to overcome the various problems associated with dealing in physical shares, such as:

- Problems of theft, fake and/ or forged transfers.
- Share transfer delays due to signature mismatches.
- Much paperwork.
- Time consuming process.
- Cost of transfer (stamp duty), etc.

**Depository System**

A **depository is an organization** where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a **depository participant**.
A depository is like a bank for securities. If an investor wishes to avail the services offered by a depository, he/she has to open an account with the depository, through a depository participant. The depository can legally transfer the beneficial ownership of securities.

**CONSTITUENTS OF DEPOSITORY SYSTEM**

There are essentially four players in the depository system:-

- The Depository Participants
- The Beneficial Owner/Investor
- The Issuer
- The Depository

**DEPOSITORY PARTICIPANTS**

The DP is the link between the investor and depository. An investor who opens a DEMAT account with a DP can utilize the services offered by the depository. While the DP processes the instructions of the investor, the account and records thereof is maintained with the depository. According to SEBI guidelines, financial institutions, banks, stockbrokers, etc. are eligible to act as DP's.

**BENEFICIAL OWNER:**

The investor who is known as beneficial owner (BO) has to open a DEMAT account through any DP for dematerialization of his holdings and transferring securities Beneficial owner is a person

whose name is recorded as such with a depository. It means a person who is engaged in buying and selling of securities issued by the companies and is registered his/ her securities with the depository in the form of book entry. He/ she has all the rights and liabilities associated with the securities.

**ISSUER:**

The issuer is the company which issues the securities. It maintains a register for recording the names of the registered owners of securities and the depositories. The issuer sends a list of shareholders who opt for the depository system. And only those companies can issue the securities which are registered under stock exchanges.

**DEPOSITORIES**

At present there are two depositories in India:

- National Securities Depository Ltd.(NSDL)
- Central Depository Services Ltd.(CDSL)

**National Securities Depository Limited (NSDL)**

National Securities Depository Limited (NSDL) is a depository that works for the National Stock Exchange (NSE) 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. It is to provide electronic depository facilities for securities being traded in capital market. NSDL has minimum net worth of Rs. 100 crores. It deals with shares in dematerialized form through depository participants who are agents of investor banks, stockbrokers and financial institutions.

**CENTRAL DEPOSITORY SERVICES LIMITED (CDSL)**

Central Depository Services Limited (CDSL) is a depository service that works for the Bombay Stock Exchange (BSE) and is promoted by the State Bank of India (SBI), Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank, Axis Bank and the Union Bank of India.
CDSL's primary focus is to provide safe, useful, reliable and secure depository services.
CDSL began its operations from February 1999 onwards after obtaining prior clearance from market watchdog Securities and Exchange Board of India (SEBI).

**FUNCTIONS OF DEPOSITORY SYSTEM**

The following are some of important facilities offered by depository system:

- Dematerialization
- Rematerialization
- Account opening
- Pledging or hypothecation of dematerialized securities

- Freezing of Demat account
- Custody of securities
- Nomination facility

**Benefits of availing depository services**

- A safe and convenient way to hold securities
- Immediate transfer of securities
- No stamp duty on transfer of securities
- Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc.
- Reduction in paperwork involved in transfer of securities
- Reduction in transaction cost
- Nomination facility

## CHALLENGES FACED BY INVESTMENT BANKERS

1. Investment banks need to identify and strengthen core businesses that could drive growth and increase competitiveness in a market featuring increased regulatory burdens and a shrinking revenue pool.
2. Investment banks of all sizes have to take a systematic view of the new environment due to regulation, market structure changes and technological possibilities to try to restore their overall profitability.
3. In order to make the best of this technology, banks need to examine their existing operational systems and determine where block chain could add the most value in the long run.
4. Financial technology (fintech) represents both a great potential for disruption and an opportunity for investment banks. In order to make the most of fintech, banking leaders need to develop a holistic framework that is built on a cohesive innovation architecture and one that utilizes meaningful partnerships and incubation programs.
5. Infrastructure-as-a-Service (IaaS) and Platform-as-a-Service (PaaS) cloud solutions could reduce banks' costs, as well as simplify and standardize IT estates. The adoption rates are now accelerating across capital markets for both private and public solutions.
6. To meet evolving client expectations and preferences, investment banks must determine which silos to tear down to deliver an appropriate client experience.
7. To succeed in the future, investment banks might need to ramp up their efforts to attract and retain the best and brightest. That means introducing new ways of working, making jobs more appealing, and creating a workplace that encourages collaboration and values creativity.

8. Historically, investment banks have chosen to give away research for free in the hope of attracting trading commissions in the future. In turn, they used investment banking fees from initial public offerings (IPOs) to support research activity. That all changed with recent regulations, which set out to separate research from investment banking activities and prevent companies from disclosing information to research analysts before it is publicly available. As a result, the opportunity of sell-side analysts to provide quality research and alpha-generating ideas has been greatly diminished.