Subiect: Financial Markets & Services (4539292)

MBA SEM 03
Module 01

INTRODUCTION TO FINANCIAL SERVICES

❖ Introduction

- A financial system is a complex, well integrated set of sub system of Financial Institutions, Markets, Instruments & Services which facilitates the transfer and allocation of funds, efficiency and effectively.

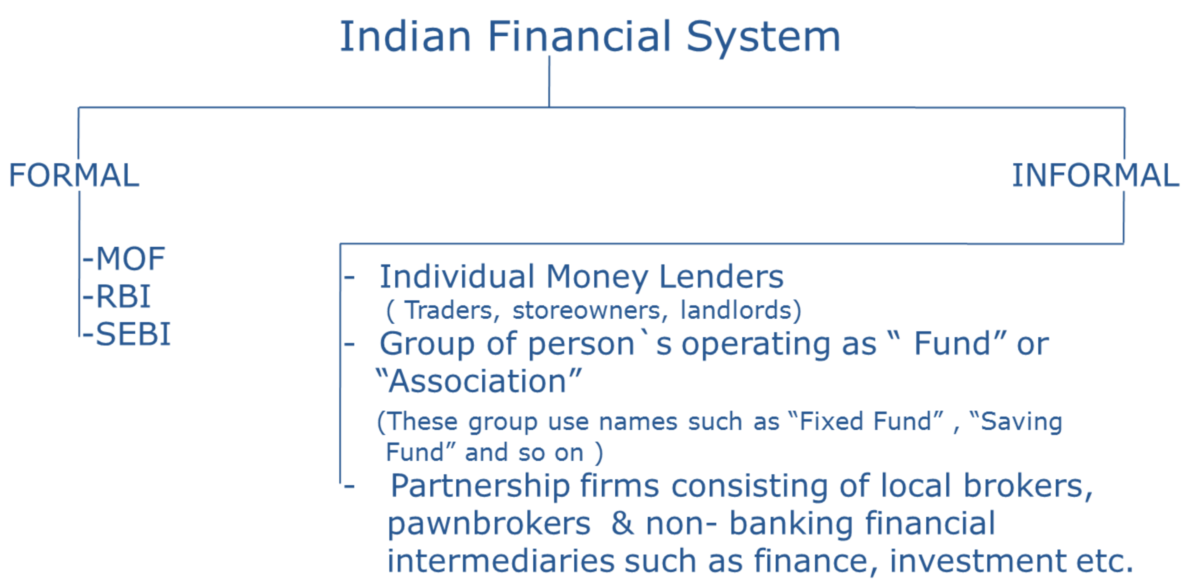
❖ Financial System

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

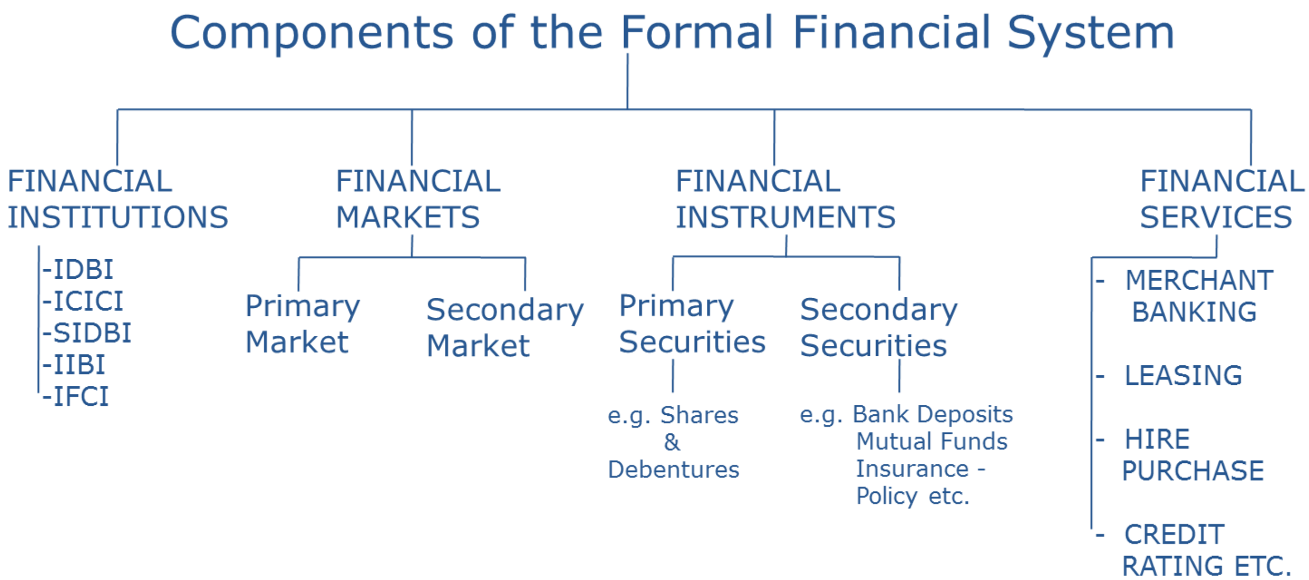
❖ Financial Dualism

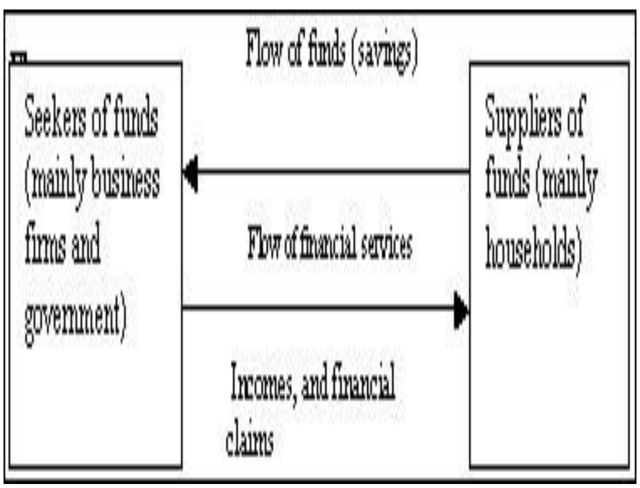
- The Financial systems of most developing countries are characterized by coexistence and cooperation between the formal and informal financial sectors. This coexistence of these two sectors is commonly referred to as ‘Financial Dualism’.

❖ Indian Financial System



❖ Components of Formal Financial system





- In short it is the orderly mechanism & structure that is available in an economy to mobilize the monetary resources/ capital from various surplus sectors of the economy allocate/ distribute the same to various needy sectors.

❖ Basic Elements of Well-Functioning Financial System

- A strong legal and regulatory environment
- Stable Money
- Sound Public Finance and Public Debt Management
- A Central Bank
- Information System
- Well-functioning securities market

❖ Function of Financial System

- Link the savers and investors
- Achieve optimum allocation of risk bearing
- Inspires the operators to monitor the performance of the investment
- Gathering and analyzing information to assist operators in taking decisions carefully
- Provides financial services such as insurance & portfolio management facilities
- Reduce the cost of borrowing

❖ Financial System Design

- A financial system is a vertical arrangement of a well-integrated chain of Financial markets & Financial Institutions.
- The Financial Systems Designs Classified:
    i. Bank Based
    ii. Market Based

- Classification of Financial Structure & Level of Development of select Economies

EXTENT OF DEVELOPMENT	BANK BASED	MARKET BASED
Developed	Japan, Germany, France, Italy	U.S., U.K., Singapore
Under-Developed	Srilanka, Pakistan, Bangladesh	Brazil, Mexico, Turkey.

❖ Indian Financial System

- It consists of formal & informal financial system:
    - Formal (Organized) Financial System
    - Informal (Unorganized) Financial System

- **Informal (Unorganized) Financial System**
    - Money lenders
    - Local bankers
    - Traders
    - Landlords
    - Pawn brokers

- **Formal (Organized) Financial System**
    - Regulators
        - **MOF** Ministry of Finance
        - **SEBI** Security Exchange Board of India
            - Capital market
            - Capital market intermediaries
            - Mutual funds including UTI
            - Venture capital
            - FIIs
            - Corporate bond market
        - **RBI** Reserve Bank of India
            - Commercial banks
            - Urban cooperative bank
            - State and district central cooperative banks
            - All India financial institutions:
            - IFCI, IIBI, Exim Bank, TFCI, SIDBI, NABARD, NHB
            - Government securities market

        - Money market
        - Foreign exchange market
    - **IRDA** Insurance Regulatory & Development Authority
        - Insurance companies
        - Public sector & private sector
        - Life and non-life
- Financial institutions (Intermediaries)
- Financial markets
- Financial instruments
- Financial services

❖ Components of Financial System

- Financial institution/intermediaries
- Financial Markets
- Financial instruments
- Financial services

➢ Financial Institutions (Intermediaries)

- Includes institutions and mechanisms which
    - Affect generation of savings by the community
    - Mobilization of savings
    - Effective distribution of savings
- Institutions are banks, insurance companies, mutual funds - promote/mobilize savings.

- Individual investors, industrial and trading companies – borrowers.

1. **Banking institution**
2. **Non-banking institution**
3. **Mutual funds**
4. **Insurance & housing companies**

1) Banking Institution

i. Scheduled commercial banks
   a. Public sector banks
   b. Private sectors banks
   c. Foreign banks in India
   d. Regional rural banks

ii. Scheduled cooperative banks

2) Non-banking Institution

i. Non-banking finance companies

ii. Development financial institutions
   a. All India financial institution
   b. State level institutions
   c. Other institutions

❖ **Development Financial Institutions**

➢ **All India Financial Institution**

- **IFCI** Industrial Finance Corporation of India
- **IDBI** Industrial Development Bank of India
- **IIBI** Industrial Investment Bank of India
- **NABARD** National Bank for Agriculture & Rural Development
- **SIDBI** Small Industrial Development Bank of India
- **IDFC** Infrastructure Development Finance Company Limited
- **EXIM Bank**
- **NHB** National Housing Bank

➢ **State Level Institutions**

- **SFC**s State Financial Corporation
- **SIDC**s State Industrial Development Corporation

➢ **Other Institutions**

- **ECGC** Export Credit Guarantee Corporation of India
- **DICGC** Deposit Insurance & Credit Guarantee Corporation

3) Mutual Funds

i. Public sector

ii. Private sector

❖ Financial Instruments

- A financial instrument is a claim against a person or an institution for the payment at a future date a sum of money and/or a periodic payment in the form of interest or dividend.
- Financial instruments may be
    - Primary Securities &
    - Secondary Securities

- Term
    - Short term
    - Medium term
    - Long term

- Type
    - Primary securities
        - Equity, Preference, Debt etc.
    - Secondary securities
        - Time deposits, MF units, Insurance policies

❖ Financial Services

- Financial services rendered by the financial intermediaries bridge the gap between lack of knowledge on the part of investors & increasing sophistication of financial instruments & markets.
- Financial services provided by the financial intermediaries.

❖ Need for Financial Services

- Borrowing and funding
- Lending and investing
- Buying and selling of securities
- Making and enabling payments and settlements
- Managing risk

➢ Financial Services

- Depositories
- Custodial
- Credit rating
- Factoring
- Forfeiting
- Merchant banking
- Leasing
- Hire purchase
- Guaranteeing
- Portfolio management
- Underwriting

❖ Financial Markets

- A Financial Market can be defined as the market in which financial assets are created or transferred.
- It consists of
    - Capital Market
    - Money Market
    - Repo Market
    - Government Security Market
    - Forex Market

❖ Distinguish between Money Market and Capital Market

POINTS	MONEY MARKET	CAPITAL MARKET
Maturity of Funds	Less than one year	Above one year
Instruments	Call Money market, Treasury Bills (TBs) Market, Commercial Bills (CBs) market, Commercial Papers (CPs) market, Certificate of Deposits (CDs), Banker's Acceptances (Bas), Repurchase Agreements (Repos), Money Market Mutual Funds (MMMF), etc.	Equity Shares, preference shares, debentures, Government securities and loans
Existence of Secondary Market	No	Yes
Place of Market	No specific place	Stock Exchanges

❖ Reserve Bank of India

- It was established by legislation in 1934 through the Reserve Bank of India Act, 1934
- It started functioning from 1 April 1935. Its central office is at Mumbai
- Though originally privately owned, since nationalization in 1949, it is fully owned by government of India
- It is the central bank of our country

➢ Objectives of RBI

- To secure monetary stability within the country
- To operate the currency to operate the currency and credit system of the country to its advantages
- Maintain the internal value of the nation's currency
- Preserve the external value of the currency
- Secure reasonable price stability and
- Promote economic growth through increasing employment, output and real income

➢ Organization of RBI

- The Reserve Bank's affairs are governed by a central board of directors.
- The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.
- Appointed/nominated for a period of four years

- Constitution:
  - **Official Directors**
    - Full-time: Governor and not more than four Deputy Governors
  - **Non-Official Directors**
    - Nominated by Government: ten Directors from various fields and one Government Official
    - Others: four Directors - one each from four local boards
  - **Functions**: General superintendence and direction of the Bank's affairs

  - **Local Boards**
    - One each for the four regions of the country in Mumbai, Calcutta, Chennai and New Delhi
  - **Membership:**
    - consist of five members each appointed by the Central Government for a term of four years
  - **Functions**
    - To advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time to time

❖ **Financial Supervision**

- The Reserve Bank of India performs this function under the guidance of the Board for Financial Supervision (BFS).
- The Board was constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India.

➢ Objectives of BFS

- Primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies.

➢ Constitution of BFS

- The Board is constituted by co-opting four Directors from the Central Board as members for a term of two years and is chaired by the Governor.
- The Deputy Governors of the Reserve Bank are ex-officio members.
- One Deputy Governor, usually, the Deputy Governor in charge of banking regulation and supervision, is nominated as the Vice-Chairman of the Board.

➢ Functions of BFS

Some of the initiatives taken by BFS include:

- Restructuring of the system of bank inspections
- Introduction of off-site surveillance,
- Strengthening of the role of statutory auditors and
- Strengthening of the internal defenses of supervised institutions.

➢ Current Focus of RBI

- Supervision of financial institutions
- Consolidated accounting
- Legal issues in bank frauds
- Divergence in assessments of non-performing assets and
- Supervisory rating model for banks.

❖ Legal Framework of RBI

➢ Umbrella Acts

- Reserve Bank of India act 1934: governs the Reserve Bank functions
- Banking Regulation Act, 1949: governs the financial sector

➢ Acts Governing Specific Functions

- Public Debt Act, 1944/Government Securities Act (Proposed):
    - Governs government debt market
- Securities Contract (Regulation) Act, 1956:
    - Regulates government securities market
- Indian Coinage Act, 1906:
    - Governs currency and coins
- Foreign Exchange Regulation Act, 1973/Foreign Exchange Management Act, 1999:
    - Governs trade and foreign exchange market
- Payment and Settlement Systems Act, 2007:
    - Provides for regulation and supervision of payment systems in India

Acts Governing Banking Operations

- Companies Act, 1956:
    - Governs banks as companies
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980:
    - Relates to nationalization of banks
- Bankers' Books Evidence Act
- Banking Secrecy Act
- Negotiable Instruments Act, 1881

Acts Governing Individual Institutions

- State Bank of India Act, 1954
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003
- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993
- National Bank for Agriculture and Rural Development Act
- National Housing Bank Act
- Deposit Insurance and Credit Guarantee Corporation Act

Main Functions of RBI

- Monetary Authority
- Regulator and supervisor of the financial system
- Manager of Foreign Exchange
- Issuer of currency
- Developmental role

- Related Functions
    - Bankers to the government
    - Banker to banks

➢ **Monetary Authority**

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors.

➢ **Regulator and Supervisor of The Financial System**

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

➢ **Manager of Foreign Exchange**

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

➢ **Issuer of Currency**

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

➢ Developmental Role

- Performs a wide range of promotional functions to support national objectives.

➢ Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

➢ Training Establishments

- Has six training establishments
- Three, namely, College of Agricultural Banking, Bankers Training College and Reserve Bank of India Staff College are part of the Reserve Bank
- Others are autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)

➢ Subsidiaries

- **Fully Owned:**
  - National Housing Bank (NHB)
  - Deposit Insurance and Credit Guarantee Corporation of India (DICGC)
  - Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL)

- **Majority Stake:**
  - National Bank for Agriculture and Rural Development (NABARD)
  - The Reserve Bank of India has recently divested its stake in State Bank of India to the Government of India.

❖ Security & Exchange Board of India (SEBI)

➢ Objectives of SEBI

- Investor protection with a view to get steady flow of savings into capital market;
- Ensuring fair practices by the issues of securities by which corporations can raise resources of least cost;
- Promotion of efficient services by brokers, merchant bankers, and other intermediaries with a view to make them competitive and professional;
- Development and regulation of securities market.
- Investor protection
- Transparency in work

➢ Functions of SEBI

Regulatory Functions

- Registration and Regulation of capital market intermediaries (Brokers, sub-brokers, and other players in the market;
- Register and regulate the working of venture capital funds and Collective Investment Schemes including mutual funds;

- Regulate the business in Stock Exchanges and any other securities market;
- Promoting and regulating Self-Regulatory Organizations (SRO);
- Prohibition of all fraudulent and unfair trade practices relating to securities market;
- Prohibition of insider trading and takeover bids and imposing penalties for such practices;
- Registering and regulating the working of depositors, custodians of securities, FIIs, credit rating agencies;
- Regulating substantial acquisition of shares and takeover of companies.
- Development Function of SEBI is to promote investors education, training intermediaries and conduct research and publish information

Developmental Functions

- Promote investors' education;
- Training of intermediaries;
- Promotion of fair practices and code of conduct for all SRO's
- Conduct research and publishing information useful to all market participants.

➢ **Limitations of SEBI**

- Limited transparency;
- Bureaucratic administration;
- Lack of professionalism;
- Long and complex procedures;
- Lack of serious approach to investors' needs;
- Fraudulent activities;
- Lack of adequate powers;

- Weak legislation;
- Too mechanical procedures;
- Minimum accountability; and
- Lack of confidence of all players in the capital market including investors, especially small.

❖ Insurance Regulatory Development Authority (IRDA)

- Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry.
- The IRDA was incorporated as a statutory body in April, 2000.
- The IRDA opened up the market in August 2000 with the invitation for application for registrations.
- Today there are 24 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 23 life insurance companies operating in the country.

➢ Objectives of IRDA

- The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

➢ Functions

- To protect the interest of and secure fair treatment to policyholders;
- To bring about speedy and orderly growth of the insurance industry
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery;
- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance
- To take action where such standards are inadequate or ineffectively enforced;
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

➢ Composition of Authority

- As per the section 4 of IRDA Act' 1999, Insurance Regulatory and Development Authority (IRDA, which was constituted by an act of parliament) specify the composition of Authority
- The Authority is a ten members team consisting of
    (a) A Chairman; (Hari Narayan)
    (b) Five whole-time members;
    (c) Four part-time members,

(all appointed by the Government of India)

➢ Duties, Powers of IRDA

- Specifying the code of conduct for surveyors and loss assessors;
- Promoting efficiency in the conduct of insurance business;
- Promoting and regulating professional organizations connected with the insurance and re-insurance business;
- Levying fees and other charges for carrying out the purposes of this Act;

- Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;
- Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938
- Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- Regulating investment of funds by insurance companies;
- Regulating maintenance of margin of solvency;

❖ Management of Non-Banking Financial Companies

- NBFC is a company whose principal business is the receiving of deposits under any scheme in any other manner or lending in any manner &
- Such other non-banking institution/ class of institutions as the RBI may specify, with the prior approval of the government and by notification in the official gazette

➢ Regulations

- The RBI regulates and supervises the NBFCs under chapter III-B of the RBI Act

➢ Difference from Bank

- Certain differences between banks and NBFCs are…
  - NBFC cannot accept demand deposits
  - It is not a part of the payment and settlement system and as such cannot provide cheques facility to its customers

➢ Regulatory & Supervisory Objectives

- Ensure healthy growth of the NBFCs
- Ensure that they function as part of the financial system within the policy framework in such a manner that their existence and functioning do not lead to any systematic irregularity

- Ensure that the quality of surveillance & supervision is sustained by keeping pace with the developments that take place in this sector of the financial system

Role of NBFCs

- Development of sectors like transport and infrastructure
- Substantial employment generation
- Broad base economic development
- Rare supplement to bank credit in rural segments
- To finance economically weaker sections

Scope of NBFCs

An NBFC is a company engaged in the business of

- loans and advances
- Acquisition of shares/bonds/debentures/securities
- Leasing
- Hire purchase
- Insurance
- Venture capital
- Merchant banking
- Broking
- Housing finance

➢ Basic Requirements for NBFCs

- It is mandatory that every NBFC should be registered with RBI to commence on any business
- It should have a minimum net owned fund of Rs 25 lakh

❖ Money Market

- Money market means market where money or its equivalent can be traded.
- Money Market is a wholesale market of short-term debt instrument and is substitute of liquidity
- Money Market is part of financial market where instruments with high liquidity and very short-term maturities ranging from overnight to one year are traded.
- Due to highly liquid nature of securities and their short-term maturities, money market is treated as a safe place.
- Hence, money market is a market where short term obligations such as
- treasury bills, call/notice money, certificate of deposits, commercial papers are bought and sold
- It is a mechanism through which short term funds are loaned and borrowed and through which a large part of the financial transactions of a particular country or of the world are cleared

➢ The Players

- Reserve Bank of India
- SBI DFHI Ltd (Amalgamation of Discount & Finance House in India and SBI in 2004)
- Acceptance Houses
- Commercial Banks, Co-operative Banks and Primary Dealers are allowed to borrow and lend.
- Individuals, firms, companies, corporate bodies, trusts and institutions can purchase the treasury bills.
- Specified All-India Financial Institutions, Mutual Funds, and certain specified entities are allowed to access to Call/Notice money market only as lenders

➢ Objectives of Money Market

The following are the important objectives of a money market:

- To provide a parking place to employ short-term surplus funds.
- To provide room for overcoming short-term deficits.
- To enable the Central Bank to influence and regulate liquidity in the economy through its intervention in this market.
- To provide a reasonable access to user of short-term funds to meet their requirements quickly, adequately and at reasonable costs.

Functions of Money Market

- It provides financial assistance to commercial bank, foreign banks and factoring companies
- It makes finance available to government under
- Helps in allocation of short-term funds
- Helps in mobilizing short term deficits and surpluses of various institutions
- Effective implementation of monetary policies
- By providing various kinds of credit instruments suitable and attractive for different sections, a money market boosts the supply of funds.

- A money market helps to avoid wide seasonal fluctuations in the interest rates.
- A money market, by boosting the supply of funds and making them readily available to the authentic borrowers, help in making funds available at cheaper rates.
- A well-organized money market, through quick transfer of funds from one place to another, helps to avoid the regional surpluses and inflexibilities of funds.
- It enhances the amount of liquidity available to the entire country.
- A money market, by providing profitable investment opportunities for short-term surplus funds, helps to enhance the profit of financial institutions and individuals.

Role of RBI in the Money Market

It is direct comes under the RBI’s regulations

- And RBI’s role…
    - To ensure liquidity & short-term interest rates are maintained at levels consists with the monetary policy objectives of maintaining price stability

- To ensure an adequate flow of credit to the productive sectors of the economy
- RBI influences liquidity through CRR of banks, Repos, change in bank rates….

➢ Importance of Money Market

- Development of trade and industry
- Development of capital market
- Smooth functioning of commercial banks
- Effective central bank control
- Assist to Formulation of suitable monetary policy

➢ Features of Money Market

- Purely for short term funds or financial assets called near money
- It deals with financial assets having maturity period upto one year only
- Transactions have to conducted without help of brokers

➢ Instruments Traded in Money Market

1) Treasury bills
2) Commercial bills
3) Certificates of depository
4) Interbank participation
5) Commercial papers
6) Money at call

1) Treasury Bills (T-bills)

- Issued by RBI on behalf of government
- Motive of tide over short term liquidity shortfalls
- It is re-paid at par on maturity
- The difference between the amount paid by the tenderer at the time of purchase (which is less than the face value) and the amount received on maturity represents the interest amount on T-bills and is known as the discount
- Tax deducted at source (TDS) is not applicable on T-bills

- **Features**

- They are negotiable securities
- They are highly liquid as they are of shorter tenure
- There is an absence of default risk
- They have an assured yield, low transaction cost, & are eligible for inclusion in the securities for SLR purpose
- At present there are 91-day, 182-day, 364-day T-bills in vogue
- 91-days T-bills are auctioned by RBI every Friday & 364-day T-bills every alternate Wednesday
- T-bills are available for minimum amount of Rs. 25,000 & in multiples thereof.

➢ Types of T-bills

1. **On-tap bills**
2. **Ad hoc bills**
3. **Auctioned T-bills**

1. On-tap bills

- It could be brought from the RBI at any time at an interest yield of 4.66%
- They are discontinued from April 1,1997

2. Ad hoc bills

- They are introduced in 1955
- Generally it is for 91-days
- It is discontinued from April 1, 1997
- Ad hoc bills were created to replenish the government's cash balances with the RBI
- It was decided between RBI & government of India that the government could maintain with the RBI a cash balance of not less than Rs 50 corer on Friday & Rs 4 corer on the other days
- Free of obligation to pay interest thereon, & whenever the balance fell below the minimum, the government account would be replenished by the creation of ad hoc bills in favor of RBI

3. Auctioned T-bills

- It the most active money market instrument
- First were introduced in April 1992
- The RBI bids in an auction from various participants & issues the bills subjects to some cut-off limits
- Yield of this instrument is market determined
- RBI issues T-bills for three maturities 91-days, 182-days, 364-days

➢ Sales of T-bills

- Sales of T-bills is conducted through an auction
- In case of auction, competitive bids are submitted by the participants to the RBI & RBI decides the cut-off yield/price & make the allotment on such a basis
- Auctions are conducted on a competitive bidding basis or
- RBI accepts non-competitive bids from state governments, non-government provident funds & other central banks
- non-competitive bids are accepted to encourage participants who do not have expertise in bidding
- non-competitive bidders allotted T-bills at a weighted average price of the successful competitive bids

Commercial Paper

- RBI introduced commercial papers in January 1990
- A commercial paper is an unsecured short-term promissory note issued at a discount by creditworthy corporate, primary dealers and all India financial institution
- It is a unsecured short term promissory note
- Negotiable and transferable by endorsement and delivery with a fixed maturity period
- It generally issued at a discount by creditworthy corporate to meet their working capital requirements
- It is also known as finance paper, industrial paper, or corporate paper

- Secondary market in CPs
    - There was very little activity in secondary market of CPs due to investors preference to hold the instruments till maturity
    - The market is developing with the entry of foreign & private sector bank as well as mutual funds. They are the major players in CPs market

➢ Commercial Bills

- Commercial bills are negotiable instruments drawn by the sellers on the buyers which are, in turn, accepted and discounted by commercial banks
- The working capital requirement of business firms is provided by banks through cash-credit/overdraft and purchase/discounting of commercial bills

➢ Types of Commercial Bills

- Demand bills
- Usance bills
- Clean bills
- Documentary bills
- Inland bills
- Foreign bill
- Hundi
- Derivative usance promissory note

➢ Features of Commercial Bills

- Bank provide credit to their customers by discounting Commercial Bills
- Commercial Bills can be traded by offering the bills for rediscounting
- In case of need for funds, banks can rediscount the bills in the money market and get ready money
- This credit is repayable on maturity of the bill

➢ Certificates of Deposit

- Certificates of deposit are short term tradable time deposits issued by commercial banks and financial institutions
- It is unsecured, negotiable, short term instruments in bearer form
- It was introduced in June 1989
- Only scheduled commercial banks excluding Regional Rural Bank and Local Area Banks were allowed to issue initially
- It can be issued to individuals, corporations, companies, trusts, funds, associates and other
- It is time deposits of specific maturity similar to fixed deposits (FDs)
- The biggest difference between the two is that CDs being bearer in form, are transferable and tradable while FDs are not

➢ Call/Notice Money Market

- The call money market accounted of the major part of the total turnover of the money market
- Mostly banks are traded there
- It is inception in 1955-56

- **Call Money Market**

- Call money market is a market for very short-term funds payable on demand and with a maturity period varying between one day to overnight
- When money is borrowed or lent for a day, it is known as call (overnight) money
- Intervening holidays and/or Sundays are excluded for this purpose

- **Notice Money Market**

- When money is borrowed or lent for more than a day up to 14 days, it is known as notice money

- **Money Market Mutual Funds**

- MMMFs bridge between small individual investors and the money market
- MMMF mobilizes savings from small investors and invest them in short term debt instruments or money market instruments

➢ Money Market Reforms

1. Since early 1990, the RBI and the government have taken various measures to strengthen and improving depth and liquidity in the money market
2. Reforms emphasized on improving transparency and efficiency of the money market
3. Initially, participation in the call market was gradually widened by including non-banks, such as financial institutions, non-banking financial companies, primary dealers, mutual funds, corporates commenced effective May 2001
4. The Discount and Finance House of India DFHI was set up in April 1988, was allowed to participate in the call/notice money market both as a borrower and lender commencing from July 1988
5. Ad hoc T-bills was abolished from April 1997 and currently only 91 day and 364-day T-bills exist
6. Several new financial instruments were introduced, like interbank participation certificates (1988), certificates of deposit (June 1989), commercial paper (January 1990) & Repos (December 1992)
7. With a view to adopting sound risk management procedures and eliminating counter party risk, Clearing Corporation of India Ltd was set up on February 15,2002
8. CCIL acts as a central counter party to all trades involving foreign exchange, government securities and other debt instruments routed through it and guarantees their settlement
9. Segment refinance facility for bank is gradually being phased out. Collateralized Borrowing and Lending Obligations CBLO was launched by CCIL in January, 2003
10. Issuance norms have been modified to encourage wider participation while strengthening the transmission of policy signals
11. Up gradation of payment system technologies

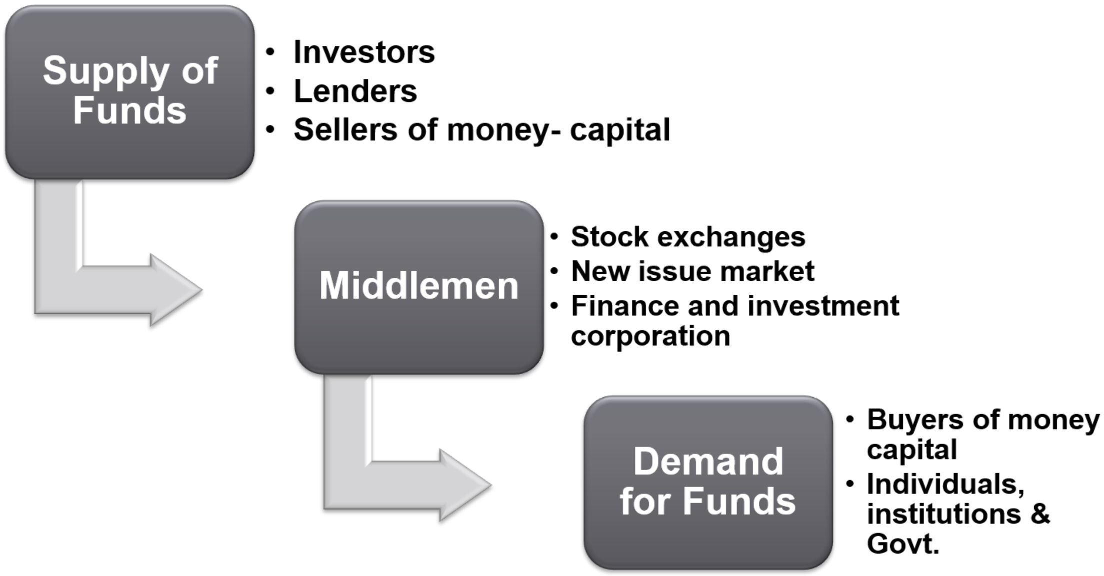
❖ Capital Market

- The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.
- It consists mainly two different types of financial security market:
  - Equity Market &
  - Debt Market
- Provided resources needed by medium and large-scale industries.
- Purpose for these resources
  - Capacity Expansion
  - Investments
  - Mergers and Acquisitions
- Deals in long term instruments and sources of funds
- The Indian capital market is more than a century old.
- Its history goes back to 1875, when 22 brokers formed the Bombay Stock Exchange (BSE).
- Today, Indian market confirms to best international practices and standards both in terms of structure and in terms of operating efficiency.

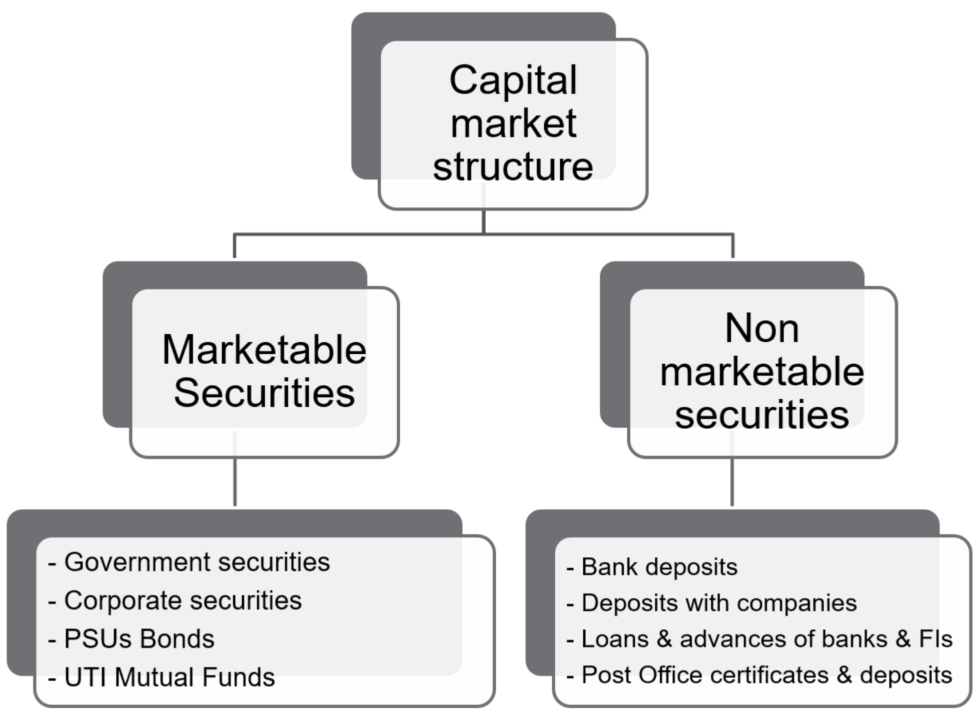
➢ Governing Mechanism

- The Company's Act 1956
- The Securities Contracts (Regulation) Act 1956 (SCRA Act)
- The Securities and Exchange Board of India (SEBI) Act, 1992.

➢ Capital Market Mechanism



➢ Capital Market Structure



- Main Activity
    - Functioning as an institutional mechanism to channelize funds from those who save to those who needed for productive purpose.
    - Provides opportunities to various class of individuals and entities.

➢ Role of Capital Market

- Mobilize long term savings to finance long term investments
- Encourage broader ownership of productive assets
- Lower the cost of transaction and information
- Enabling quick valuation of financial instruments both equity and debt
- Enable wider participation by enhancing the width of the market by encouraging participation through networking institution and associating individuals

➢ Functions of Capital market…

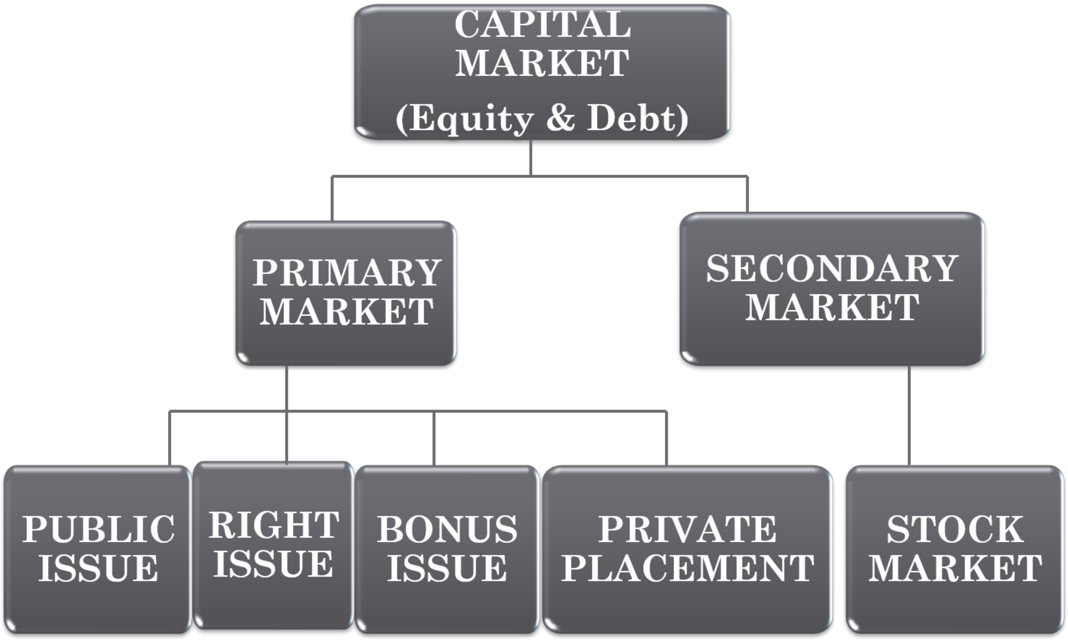
- Broadcast information efficiently for enabling participants to develop an informed opinion about investment, disinvestment or holding a particular financial asset
- Provide operational efficiency through:
    - Simplified transaction procedures
    - Lowering settlement timings
    - Lowering transaction costs

- Provide insurance against market risk or price risk through derivative trading & default risk through investment protection fund
- Develop integration among
    - Real and financial sectors
    - Equity and debt instruments
    - Long and Short-term funds
    - Private sector and government sector
    - Domestic and external funds
- Direct the flow of funds into efficient channels through investment, disinvestments and reinvestments

➢ Importance of Capital Market

- Pooling the capital resources and developing initiatives investors
- Solve the problem of scarcity of funds
- Assemble the small and scattered savings
- Boost the availability of inventible funds
- Growth of joint stock business
- Provide a number of profitable investment opportunities for a small savers.

- **Classification of Capital Market**



- **Primary Markets**
    - Public issues
    - Right issues
    - Bonus Issues
    - Private placement
        - Domestic market
        - Foreign market

- **Secondary Markets**
    - **NSE** (National Stock Exchange)
    - **BSE** (Bombay Stock exchange)
    - **OTCEI** (Over The Counter Exchange of India)
    - **ISE** (Interconnected Stock Exchange of India)
- **Regional Stock Exchanges**

- **Derivatives Markets**
    - Exchange traded
    - Future and option
        - Index
        - Stock

- **Debt Market (gilt)**
    - Private corporate debt
    - PSU bond market
    - Government securities
        - Primary segment
        - Secondary segment

- **Capital Market Institutions**

- Development banks
- Specialized financial institutions
- Investment institutions
- State level development banks
- Mutual funds
- Lease companies
- Financial service companies
- Commercial banks
- Other specialized institutions

➢ Capital Market Reforms

- Account settlement system was replaced by rolling settlement, thus reducing scope for speculation
- Rolling settlement cycle was shortened from T+5 to T+3 with effect from April 1,2002
- This process was enabled by a shift to electronic book entry transfer system through depository mechanism
- Indian companies were allowed to raise funds from abroad, through American/ Global Depository Receipts (ADRs/GDRs), foreign currency convertible bonds (FCCBs) & external commercial borrowings (ECBs)
- RBI allowed two-way fund transferability of ADRs/GDRs in February 2002
- FIIs were allowed to participate in the capital market
- Measures to expand market for corporate bonds: exchange traded currency and interest rate futures are to be launched and a transparent credit derivatives market is to be developed with appropriate safeguards
- Requirements of PAN has been extended to all transactions in the financial market, subject to suitable threshold exemption limits

❖ Primary Market

- The issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment.
- They do so either through public issues or private placement.
- There are two major types of issuers who issue securities.
    - The corporate entities issue mainly debt and equity instruments (shares, debentures, etc.)
    - The governments (central and state governments) issue debt securities (dated securities, treasury bills)

- It is a market for new issues
- It also called new issue market
- It is a market for a fresh capital
- In Primary Market, Securities are offered to the public for subscription, for the purpose of raising the capital or funds.

- In India, New capital issues are floated through,
    - Rights & private placement
    - By government companies
    - Non-government public limited companies
    - Public sector undertaking
    - Banks &
    - Financial institution

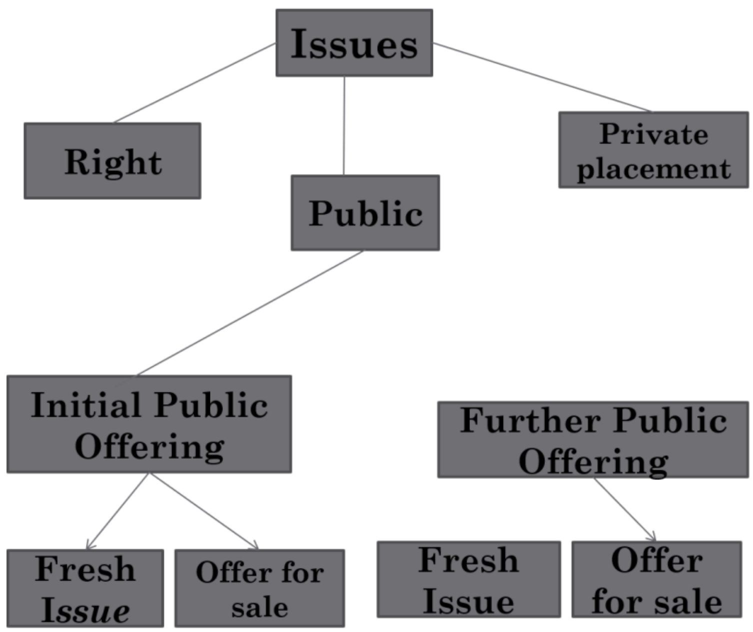
- An unlisted issuer making a public issue i.e. (making an IPO) is required to satisfy the following provisions
- Intermediaries to an issue
    - Merchant banker
    - Registrar to the issue
    - Bankers to the issue

➢ **New Issue in Primary Market**

- The issue of securities in the primary market is subjected to fulfillment of a number of pre-issue guidelines by SEBI and compliance to various provision of the Company Act.

- **The Issuer Company shall meet the following requirements:**
    1. Net Tangible Assets of at least Rs. 3 crores in each of the preceding three full years.
    2. Distributable profits in at least three of the immediately preceding five years.
    3. The issue size does not exceed 5 times the pre- issue net worth as per the audited balance sheet of the last financial year
    4. Net worth of at least Rs. 1 Crore in each of the preceding three full years.
    5. If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

➢ Classification of Issue



➢ Public Issue

- It involves raising of funds directly from the public and get themselves listed on the stock exchange
- In case of new companies, the face value of the securities is issue at par, and
- In the case of existing companies, the face value of securities is issued at premium

➢ Initial Public Offer (IPO)

- When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This covers way for listing and trading of the issuer's securities in the Stock Exchanges.

Further public offer (FPO)

- When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called FPO.

Right Issue

- Right issue is the method of raising additional finance from existing members by offering securities to them on pro rata bases.
- The rights offer should be kept open for a period of 60 days and should be announced within one month of the closure of books.

Bonus Issue

- Companies distribute profits to existing shareholders by way of fully paid bonus share in lieu of dividend.
- These are issued in the ratio of existing shares held.
- The shareholders do not have to make any additional payment for these shares

Private Placement

- Private Placement is an issue of shares by a company to a select group of persons under the Section 81 of the companies act 1956. It is a faster way for a company to raise equity capital.

❖ Book Building

- It is a process of price discovery used in public offers
- The issuers set a base price and a band within which the investor is allowed to bid for shares
- Investors has to bid for number of shares he wishes to subscribe to within this band
- An order book, in which investors can state number of shares they are willing to buy at a price within the band
- Once the issue period is over and book has been built, book running lead manager (a merchant banker who managers issue) along with the issuers arrivers at a cut off price

- Cut off price is a price at which shares are issued to investor
- Investors bidding at a price below cut off price are ignored
- Cut off price is arrived at by the method of Dutch auction
- In Dutch auction, price of an items is lowered until it gets its first bid and then the items are sold at that price

- Book building is a process by which demand for the proposed issue is bring out and built up the price at which the securities will be issued is determined on the basis of the bids received
- In other words, it is a process of offering securities in which bids at various prices from investors through syndicate, members and based on bids, demand for the security is assessed and its price discovered.

➢ Reverse Book Binding

- Reverse book binding is a price discovery mechanism for companies who want to delist their shares or buy back shares from the share holders

➢ Delisting of Securities

- Delisting of securities means permanent removal of securities of a listed company from a stock exchange

❖ Secondary Market

- Secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return.
- A variant of secondary market is the forward market, where securities are traded for future delivery and payment in the form of futures and options.
- The futures and options can be on individual stocks or basket of stocks like index.
- Two exchanges,
  - National Stock Exchange (NSE)
  - Bombay Stock Exchange (BSE)
- Provide trading of derivatives in single stock futures, index futures, single stock options and index options. Derivatives trading commenced in India in June 2000

- Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the stock exchange.
- Secondary market comprises of Equity market and Debt market.
- It is the trading avenue in which the already existing securities are traded amongst investors.
- Banks facilitate secondary market transactions by opening direct trading and demat accounts to individuals and companies.

➢ Financial Instruments Dealt in Secondary Market

- Equity Shares
- Right shares
- Bonus Shares
- Preference shares
    - Cumulative Preference Shares
    - Cumulative Convertible Preference Shares
    - Participating Preference Shares
- Debentures
- Bonds
    - Coupon Bonds
    - Zero coupon bonds
    - Convertible Bond
    - Treasury Bills

➢ Equity Shares

- An equity share is commonly referred to as an ordinary share.
- It is a form of fractional ownership in which a shareholder, as a fractional owner, undertakes the entrepreneurial risk associated with the business venture.
- Holders of the equity shares are members of the company and have voting rights.

➢ Right Shares

- This refers to the issue of new securities to the existing shareholders, at a ratio to those shares already held.

➢ Bonus Shares

- These shares are issued by the companies to their shareholders free of cost by capitalization of accumulated reserves from the profit earned in the earlier years.

➢ Preference Shares

- These shareholders do not have voting rights.
- Owners of these shares are entitled to a fixed dividend or a dividend calculated at a fixed rate to be paid regularly before any dividend can be paid in respect of equity shares.
- These shareholders also enjoy priority over the equity shareholders in the payment of surplus.

➢ Cumulative Preference Shares

- This is a type of preference shares on which dividend accumulates if it remains unpaid.

❖ Cumulative Convertible Preference Shares

- This is a type of preference shares on where the dividend payable on the same accumulates, if not paid. After a specified date, these shares will be converted into equity capital of the company.

❖ Participating Preference Shares

- This refers to the right of certain preference shareholders to participate in profits, after a specified fixed dividend contracted for is paid.

❖ Debentures

- Debentures are bonds issued by a company bearing a fixed rate of interest usually payable half-yearly, on specific dates and the principal amount repayable on a particular date on redemption of the debentures.
- Debentures are normally secured against the asset of the company in favor of the debenture holder.

❖ Bonds

- A bond is a negotiable certificate evidencing gratitude. It is normally unsecured.

❖ Coupon Bonds

- These are normal bonds on which the issuer pays the investor interest at the predetermined rate at agreed intervals, normally twice a year.

➢ Zero Coupon Bonds

- A bond issued at a discount and repaid at a face value is called as Zero-coupon bonds.
- No periodic interest is paid in this case.

❖ Convertible Bond

- A bond giving the investor the option to convert the bond into equity at a fixed conversion price is referred to as a Convertible Bond.

❖ Treasury Bills

- These are short term bearer discount security, issued by the Government as a means of meeting its cash requirements.

❖ Commonly Used Terms in Capital Market

❖ Securities Transaction Tax (STT)

- Securities Transaction Tax is a tax being levied on all transaction done on the stock exchanges at rates prescribed by the central government from time to time.

❖ Rolling Settlement

- In Rolling Settlement, trades executed during the day are settled, based on the Net obligations for the day. Presently the trade pertaining to the rolling settlement are settled on a T+2 day basis, where T stands for the trade day

❖ Pay- in Day and Pay-out Day:

- Pay-in day is the day when the brokers make payments or delivery of securities to the exchange.
- Pay-out day is the day when the exchange makes payment or delivery of securities to the broker.
- Settlement cycle is on a T+2 rolling settlement basis

❖ Depository

- A depository is like a bank wherein the deposits are securities (viz. shares, debentures, bonds, government securities, units etc.) in electronic form.
- There are two types of Depository in our country:
  - NSDL
  - CDSL

❖ NSDL (National Securities Depository Limited)

- It was first depository set up in India
- It was promoted by IDBI, UTI, NSE and SBI
- It was registered on 7 June, 1996 with SEBI and commenced operations in November 1996
- NSDL aims at ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimize risk and reduce costs.
- In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts.
- Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork.
- Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates Promoters / Shareholders

❖ CDSL (Central Depository Services Limited)

- CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants.
- Some of the important milestones of CDSL system are:
    - CDSL received the certificate of commencement of business from SEBI in February, 1999.
    - Honorable Former Union Finance Minister, Shri Yashwant Sinha flagged off the operations of CDSL on July 15, 1999.
- All leading stock exchanges like,
    - The National Stock Exchange
    - Calcutta Stock Exchange
    - Delhi Stock Exchange
    - The Stock Exchange of Ahmadabad etc.

    have established connectivity with CDSL.

❖ Benefits of a Depository System

- Immediate allotment, transfer and registration of securities
- No stamp duty on transfer of securities
- Elimination of risks associated with physical certificate
- Reduction in paperwork and transaction cost
- Decrease in settlement risk and fraud

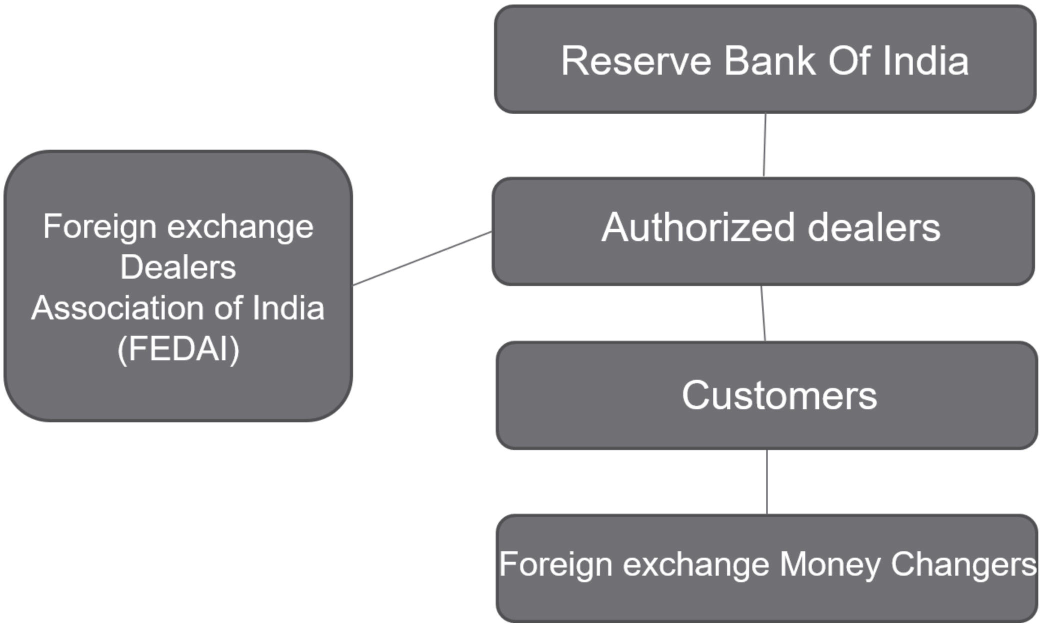
❖ Foreign Exchange Market

- It refers to process of converting home currencies into foreign currencies and vice versa
- Foreign exchange is the system or process of converting one national currency into another, and of transferring money from one country to another
- The foreign exchange market (forex, FX, or currency market) is a global, worldwide decentralized financial market for trading currencies.
- Financial centers around the world function 24*7
- The foreign exchange market determines the relative values of different currencies.
- The primary purpose of the foreign exchange is to assist international trade and investment, by allowing businesses to convert one currency to another currency
- It also supports direct speculation in the value of currencies, and the carry trade, speculation on the change in interest rates in two currencies

➢ Functions of Forex Market

- To make necessary arrangements to transfer purchasing power from one country to another
- To provide adequate credit facilities for promotion of foreign trade
- To cover foreign exchange risks by providing hedging facilities

➢ Structure of FOREX Market



➢ Instruments of Credit Traded

- Telegraphic Transfers (TT)
- Mail Transfers (MT)
- Drafts and Cheques
- Bills of Exchange.

❖ Repo Market

- It is a transaction in which two parties agree to sell and repurchase the same security. Under such an agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price
- The Repo/Reverse Repo transaction can only be done at Mumbai between parties approved by RBI and in securities as approved by RBI (Treasury Bills, Central/State Government securities).

➢ Advantages of Repo

1. Repo involves instant legal transfer of ownership of the eligible securities.
2. Repo can be used to facilitate Government's cash management.
3. Repo is a very powerful and flexible money market instrument for modulating market liquidity.
4. Repo also serves the purpose of an indirect instrument of monetary policy at the short-end of the yield curve.

❖ Government Security Market

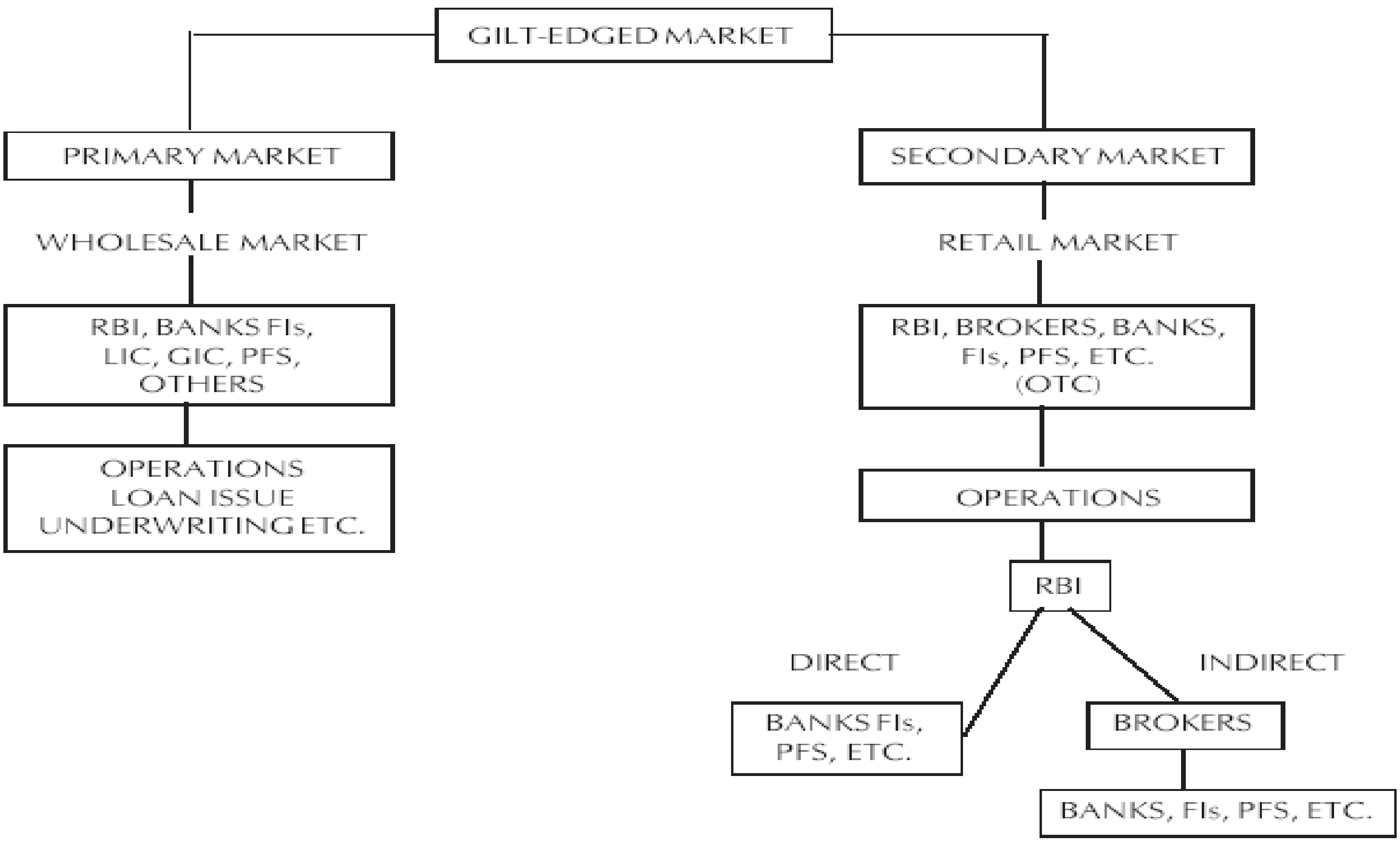


Fig. 9.1 Gilt-Edged Market Segmentation

➢ Salient features of Government Securities

1. These securities are normally issued in denomination of Rs. 1,000.
2. The interest on Government securities is payable half yearly. Interest in respect of Central and State Government securities exempt from income tax subject to certain limits.

3. Central Government securities are more liquid than State Government and Semi-Government securities. The market activity in respect of semi-Government securities is very less.
4. There are three forms of Central and State Government Securities,
    a. Stock certificate (SC)
    b. Promissory note (PN) and
    c. Bearer bond.

    However, at present most government securities are in the form of promissory notes (PN). Promissory notes of any loan can be converted into stock certificates of any other loan or *vice versa*.
5. Government Securities are issued through the Public Debt Office (PDO) of the RBI.
6. The RBI does have its approved brokers for marketing of government securities.
7. The gilt-edged market is an 'over-the counter' market
8. And each sale and purchase have to be separately negotiated.
9. Orders received locally by members of the stock exchange are passed on to the security brokers and dealers who then try various sources, among which are banks.
10. **Maturity Structure of Debt**: With the developments taken place in the financial system, the maturity structure of government debt has considerably shortened. The longest maturity is kept at 10 years. Further, with the funding of Treasury Bills into maturities of less than ten years, the overall term structure of debt has shortened.
11. However, institutional investors like LIC prefer relatively longer maturities of more than 15 years.
12. **Market Structure**: Government Securities are deemed to be listed on stock exchanges and as such there is no separate listing requirement for them.
13. The primary issues of government securities are notified to the public through issue of government notification and press communication.
14. SEBI has also been granted 'No objection' to these issues without insisting on selection of offer document.

The RBI has advised the banks that, securities transactions should be undertaken directly between banks and no bank should engage the services of any brokers. In such transactions, banks may however undertake securities transactions among themselves or with non-bank clients through members of the NSE wherein transactions are transparent.

15. **Tax Deduction at Source (TDS)**:
    - Interest on government securities is subject to tax deducted at source.
    - This has led to the unhealthy practice of voucher trading around interest payments dates purely to gain tax advantage.
    - The Union of Budget of 1997 has removed TDS on interest income of government securities. This helps in improving the secondary market for government securities

❖ CRR & SLR

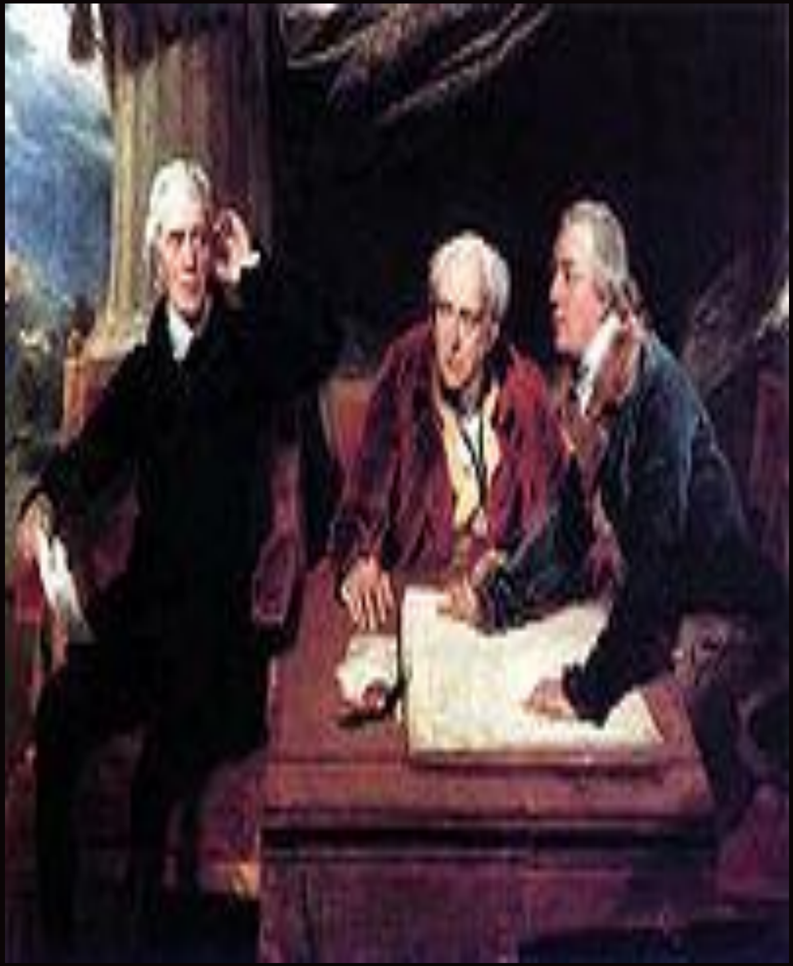
- CRR & SLR are techniques for monetary control used by the RBI to achieve specific macro-economic objectives
- CRR (Cash Reserve Ratio) refers to the cash that banks have to maintain with the RBI as a certain percentage of their total demand and time liabilities
- SLR (Statutory Liquidity Ratio) refers to the mandatory investment that banks have to make in government securities

Financial Markets & Services

Merchant Banking

Origin

- The term merchant banking originated from the London who started financing foreign trade through acceptance of bills
- Later they helped government of under developed countries to raise long term funds
- Later these merchants formed an association which is now called "Merchant Banking and Securities House Association"



Meaning Of Merchant Banking

- “Merchant banking means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, underwriting or subscribing to the securities underwriter, manager, consultant, advisor or rendering corporate advisory services in relation to such issue management”
  - By The SEBI Rules, 1992

Definition

- “Merchant banks mostly provide advisory services, issue management, portfolio management and underwriting, which require less capital but generate more income.”

Merchant banking in India

- Need for merchant banking was felt with rapid growth in number & size of issues made in primary market.
- Merchant banking services were started by foreign banks,in 1967 & in 1970 .
- Merchant banking services were offered along with other traditional banking services.
- SBI was first Indian bank to set up Merchant banking division in 1972.

Difference between commercial banking & merchant banking

Commercial Banking	Merchant Banking
1. Deals with Debt & Debt related finance.	1. Deals with Equity & Equity related finance.
2. Asset oriented.	2. Management oriented.
3. Generally avoid risks.	3. Willing to accepts risks.
4. Offer loan and borrowing.	4. Offer mainly financial advises and services
5. Deal with small industry and public.	5. Essentially wholesale banking means they deal with selective large industry not with the public

Services rendered by Merchant Banker

1. Corporate Counseling
2. Project Counseling and Pre-investment Studies
3. Capital Restructuring
4. Credit Syndication and Project Finance
5. Issue Management and Underwriting
6. Portfolio Management
7. Non-resident Investment
8. Working Capital Finance
9. Acceptance Credit and Bill Discounting
10. Mergers, Amalgamations and Takeovers
11. Venture Capital Financing
12. Lease Financing
13. Foreign Currency Finance

Services of Merchant Banks

Sr No	Particulars	Summary
1	**Corporate Counseling**	Covers the entire field of merchant banking, Ltd to giving suggestions
2	**Project Counseling**	Preparing project report for govt. approval , financial assistance

3	**Loan Syndication**	Assistance rendered to get term loan for project, help client make appraisal, designing capital structure etc
4	**Issue Management**	Marketing corporate securities, intermediary in transfer of capital from one who owns to needy
5	**Underwriting**	Guarantee given by the underwriter, make raising of external resource easy
6	**Managers to Issue**	Drafting, completion of formalities, appoint Registrar etc

7	**Portfolio Management**	Investment in different kind of securities
8	**Mergers and takeovers**	Middlemen in setting negotiation
9	**Off Shore Finance**	Help in areas involving foreign currency
10	**Non- Resident Investment**	Provide help in better and smooth trade to NRIs

Registration of merchant banker

1. The applicant should be a body corporate.
2. The applicant should not carry on any business other than those connected with the securities market.
3. The applicant should have necessary infrastructure like office space, equipment, manpower, etc.
4. The applicant must have at least two employees with prior experience in merchant banking.
5. Any associate company, group company, subsidiary or inter connected company of the applicant should not have been a registered merchant banker.
6. The applicant should not have been involved in any securities scam or proved guilty for any offence.
7. The applicant should have a minimum net worth of Rs. 5 crores

Functions of a merchant banker

1. Management of debt and equity offerings
2. Promotional activities
3. Placement and distribution
4. Corporate advisory services
5. Project advisory services
6. Loan syndication
7. Providing venture capital and mezzanine financing
8. Leasing Finance
9. Bought out deals
10. Non-resident Investment
11. Advisory services relating to mergers and acquisitions
12. Portfolio management

Issue management

Issue management refers to management of securities offering of clients to the general public and existing shareholders on right basis. Issue managers are known as Merchant Banker or Lead managers

Pre-issue activities

- They prepare copies of prospectus and send it to SEBI and then file them to Registrar of Companies
- They conduct meetings with company representatives and advertising agencies to decide upon the date of opening issue,closing issue, launching publicity campaign etc..
- They help the companies in fixing up the prices for their issues

Post-issue activities

- It includes ….
- Collection of application forms,
- Screening of applications,
- Deciding allotment procedure,
- Mailing of allotment letters,,
- Share certificates and refund orders

Type of Issues

Issues are of three types. They are as follows:

1. Public Issue,
2. Right Issue, and
3. Private Placements.

Public Issue-Reasons for Going Public

1. To raise funds for financing capital expenditure needs like expansion, diversification, etc.
2. To finance increased working capital requirement.
3. As an exit route for existing investors.
4. For debt financing.

Public Issue-Advantages

1. The IPO provides avenues for funding future needs of the company.
2. It provides liquidity for the existing shares.
3. The reputation and visibility of the company increases.
4. Additional incentive for employees in the form of the company's stocks. This also helps to attract potential employees.
5. It commands better valuation for the company.

Public Issue-Disadvantages

1. The profit earned by the company should be shared with its investors in the form of dividends.
2. An IPO is a costly affair. Around 15-20% of the fund realised is spent on raising the same.
3. In an IPO, the company has to disclose results of operations and financial position to the public and the Securities and Exchange Board of India (SEBI).
4. The company has to invest substantial management time and effort.

Marketing of the Issue

1. Timing of the Issue
2. Retail Distribution
3. Reservation of the Issue
4. Advertising Campaign

Rights issue

Existing shareholders have pre-emptive right in taking part in the right issue.

In right issue, shares are offered to existing shareholders according to the proportion of their shareholding.

Private placement

- The direct sale of shares by a company to investors is called private placement.
- No prospectus is issued in private placement.
- Private placement covers equity shares, preference shares and debentures.

Issue manager

- Issue managers generally do issue management. To be an issue manager, they register themselves with SEBI.

Roles of Issue Manager

- Merchant banker floats the shares for and behalf of issuing company. It may be either right or public issue. It is the stipulation of SEBI.
- One of the important areas of issue management relates to capital structuring, capital gearing and financial planning for the company. Merchant banker acts as a master designer in performing these activities.
- Merchant banker underwrites and invests in the issue lead managed by them.
- They invest, continue to hold and offer buy and sell quotes for the scrip's of the company after listing. His association with the company is not merely restricted to management of issue but continues throughout.

Roles of Issue Manager cont..

- Every merchant banker is expected to perform due diligence while managing a capital issue.
- A merchant banker is required to coordinate with a large number of institutions and agencies.
- They are expected to interact and file offer documents with SEBI while managing issues.
- They file number of reports related to issues. They have to revolve around SEBI.
- Marketing of an issue is an essential component of issue management. Merchant banker makes number of promises to the potential investors. He puts him in the shoes of a dream merchant.

Pricing of public issues

1. A new company set up by entrepreneurs without a track record will be permitted to issue capital to public only at par.
2. A new company set up by existing companies with a five-year track record of consistent profitability will be free to price its issue provided the participation of the promoting companies is not less than 50 per cent of the equity of the new company and the issue price is made applicable to all new investors uniformly.
3. An existing private/closely held company with a three-year track record of consistent profitability shall be permitted to freely price the issue.
4. An existing listed company can raise fresh capita! by freely pricing further issue.

Code of conduct of merchant bankers

- A merchant banker in the conduct of his business shall observe high standards of integrity and fairness in all his dealings with his clients and other merchant bankers.
- A merchant banker shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
- A merchant banker shall not make any statement or become privy to any act, practice or unfair competition, which is likely to be harmful to the interests of other merchant bankers.
- A merchant banker shall not make any exaggerated statement, whether oral or written, to the client either about the qualification or the capability to render certain services or his achievements in regard to services rendered to other clients.

Code of conduct of merchant bankers

A merchant banker shall not—

1. Creation of false market;
2. Price rigging or manipulation
3. Passing of price sensitive information to brokers,
4. Disclose to other clients, press or any other party any confidential information about his client, which has come to his knowledge
5. Deal in securities of any client company without making disclosure to the Board.

Merchant banking regulations

- Certificate from SEBI is a must. They are of four types:

1. **Category I :** Can act as Issue managers
2. **Category II :** Can act only as co-managers
3. **Category III :** Can act as co-managers but cannot undertake portfolio management
4. **Category IV :**Can merely act as consultant or advisor to issue of capital

Merchant banking regulations

- Category I
  - To act as lead manager and carry on any activity of the issue management, including preparation of prospectus and other information relating to the issue, determining financial structure, tie up of financiers and final allotment and refund of the subscription(to act as adviser, consultant, underwriter, portfolio manager)
- Category II
  - To act as adviser, manager, underwriter, portfolio manager

Merchant banking regulations

- Category III
  - To act as underwriter, adviser and consultant to an issue
- Category IV
  - To act only as adviser or consultant to an issue

Registration charges

1. **Category I Merchant Banker-** A sum of Rs. 2.5 lakhs to be paid annually for the first two years.
2. **Category II Merchant Banker-** A sum of Rs. 1.5 lakhs to be paid annually for the first two years.
3. **Category III Merchant Banker-** A sum of Rs 1 lakh to be paid annually for the first two years.
4. **Category IV Merchant Bankers-** A sum of Rs. 5,000 to be paid annually for the first two years.

Book-Building

- Book-building is a process of offering securities in which bids at various prices from investors through syndicate, members and based on bids, demand for the security is assessed and its price discovered.

Other Requirements of Book-building

1. Bids to remain open for at least 5 days,
2. Only electronic bidding is permitted,
3. Bids are submitted through syndicate members,
4. Investors can bid at any price,
5. Retail investors have option to bid at cut off price,
6. Bidding demand is displayed at the end of everyday,
7. The lead manager analyses the demand generated and determines the issue price in consultation with the issuer

e-IPOS

- A company proposing to issue capital to public through on-line system of the stock exchange has to comply with Section 55 to 68A of the Companies Act, 1956 and SEBI Guidelines,2000.

Banks providing merchant banking services in india

- All Commercial banks
- Foreign banks like National Grindlays Bank, Citibank, HSBC bank etc.
- Development banks like ICICI,IFCI,IDBI etc..
- SFC , SIDCs
- Private firms like JM Financial and Investment service , DSP Financial Consultants, Ceat Financial Services, Kotak Mahindra, VMC Project Technologies, Morgan Stanley, Jardie Fleming, Klienwort Benson etc…

Some problems of merchant bankers

- SEBI stipulates high capital adequacy norms for authorisation which prevents young,specialised professionals into merchant banking business
- Non co-operation of the issuing companies in timely allotment of securities and refund of application of money etc.. is another problem
- Yet merchant banking is vast but should develop adequate expertise to provide a full range of merchant banking services

Credit Rating

Definition

- “Credit ratings help investors by providing an easily recognizable, simple tool that couples a possibly unknown issuer with an informative and meaningful symbol of credit quality.”
- Credit rating is, essentially, the symbolic indicator of the current opinion of the rating agency regarding the relative ability and willingness of the issuer of a financial (debt) instrument to meet the (debt) service obligations as and when they arise.

Credit rating agency

- "An agency that performs the rating of debt instruments is known as credit rating agency".
- The scope of a credit rating agency is not limited to rating of debts.
- Credit rating agencies now undertake financial analysis and assessment if financial products, individuals institutions, and governments.

Origin

Growth of credit rating agencies

Year	Credit Rating Agencies
1841	Mercantile credit agency
1900	Moody's Investors Service
1916	Poor Publishing House
1924	Fitch Publishing Company
1941	Standard & Poor
1966	McGraw Hill

1972	Canadian Bond Rating Service
1975	Japanese Bond rating Institute
1980	Duff & Phelps Credit Rating Company
1987	Credit Rating Information Services of India Ltd. (CRISIL)
1991	Investment Information and Credit Rating Agency of India (ICRA)
1994	Credit Analysis and Research Ltd. (CARE)
1996	Duff and Phelps Credit Rating India (P) Ltd.

Rating Process

1. Rating is an interactive process with a prospective approach. It involves series of steps. The main points are described as below:
2. Mandate
3. Team
4. Information
5. Secondary Data
6. Meetings and Visits
7. Preview/Meeting
8. Committee Meeting
9. Rating Communication
10. Rating Reviews
11. Surveillance

Key areas considered in a rating analysis

1. **BUSINESS RISK:**

   Industry Characteristics, Performance & Outlook, Operating Position, Technology aspects, Business Cycle etc.

2. **FINANCIAL RISK:**

   Financial Management, Accounting Policies & Foreign Currency Transactions are seen & evaluated.

3. **MANAGEMENT ASSESSMENT:**

   Background and History of Issuer , Philosophy, Organizational Structure & Management Capabilities under Stress.

4. **ENVIRONMENT ANALYSIS:**

   Regulatory environment, Operating environment , Tax Status, Areas of Special Significance to the Company etc.

Key areas considered in a rating analysis

- Rating, usually expressed in alphabetical or alphanumeric symbols, are a simple and easily understood tool enabling the investor to differentiate between debt instruments on the basis of their underlying credit quality.

Key areas considered in a rating analysis

- Cedit rating is thus symbolic indicators…
- It is emphasize on communicating to the investors…
- Actually talking, the ranking is an opinion on the future ability…

Credit rating serves following functions.

1. Provides superior information.
2. Low cost information
3. Bases for a proper risk and return.
4. Healthy discipline on corporate borrowers.
5. Greater credibility to financial and other representation
6. Formation of public policy.

Importance of credit rating

- Credit rating helps in the development of financial market.
- Credit rating enables investors to draw up the credit-risk profile and assess the adequacy or otherwise of the risk-premium offered by the market.
- It saves the investors time and enables them to take a quick decision and provide them better choices among available investment opportunities.
- Credit rating is a tools in the hands of financial intermediaries, such as banks and financial institutions, that can be effectively employed for taking decisions relating to lending and investment.

Benefits to investors

- Safeguards against bankruptcy
- Recognition of Risk – easily recognizable symbols e.g. AAA
- Credibility of issuer – Independent rating
- Easy understandability of investment proposal – quick decision

Benefits to investors[cont..]

- Saving of Resources
- Independence of investment decisions – need not depend on advice of others.
- Choice of Investment – depending upon their own risk profile.
- Benefits of Rating surveillance – on continuous basis.

Benefits to company

- Lower cost of borrowing
- Wider audience for borrowing
- Rating as a marketing tool
- Reduction of cost in public issues
- Motivation for growth
- Unknown issuer
- Benefits to brokers and financial intermediaries

Demerits of credit rating

- Biased rating and misrepresentation
- Static study
- Concealment of material information
- Rating is no guarantee for soundness of company
- Human bias
- Reflection of temporary adverse conditions
- Down grade
- Difference in rating of two agencies

Criticisms

- Since issuers are charged for ratings by CRAs, i.e., the issues are pay masters, the independence of ratings becomes questionable.
- CRAs are not accountable for the ratings given by them.
- Ratings may lead to herding behavior thereby increasing the volatility of capital flows.
- Credit ratings change infrequently since the rating agencies are unable to constantly monitor developments.

Users Of Credit Rating

- Credit ratings are used by investors, issuers, investment banks, broker-dealers.
- Ratings use by bond issuers
- Ratings use by investment banks and broker-dealers
- Ratings use in structured finance

Regulations

- In India, in 1998, SEBI constituted a Committee to look into draft regulation for CRAs that were prepared internally by SEBI. The Committee held the view that in keeping with international practice, SEBI Act 1992 should be amended to bring CRAs outside the purview of SEBI for a variety of reasons.
- In consultation with Government, in July 1999, SEBI issued a notification bringing the CRAs under its regulatory ambit in exercise of powers conferred on it by Section 30 read with Section 11 of the SEBI Act 1992.

Standard and poor's credit rating methodology

- S&P's traces its origins to the publication, in **1860.**
- S&P's credit ratings, indices, investment research and data provide financial decision-makers with the information and opinions they need to feel confident about their decisions.
- The analytical methodology focuses on :
  - Range of economic system and administrative factors
  - Budgetary performance and flexibility
  - Entities own financial position.

International credit rating

1. **A.M. Best Company, Inc.**
   US -- NRSRO
2. **Agusto & Co. Ltd.**
   Nigeria
3. **Ahbor Rating**
   Uzbekistan
4. **Apoyo & Asociados Internacionales S.A.C.**
   Peru -- Fitch Associate
5. **Bank Watch Ratings S.A.**
   Ecuador -- Fitch Affiliate

Credit Rating Agency in India

- There are four credit rating agencies in India.
  1. Credit Rating Information Services of India (CRISIL) Ltd.
  2. Investment Information and Credit Rating Agency of India (ICRA) Ltd.
  3. Credit Analysis and Research (CARE) Ltd.
  4. Onida Individual Credit Rating Agency of India (ONICRA) Ltd.

CRISIL LTD.

- Credit Rating Information Services of India (CRISIL) Ltd.
- As a first rating agency in India, it was promoted in 1987 jointly by the ICICI and the UTI.
- The Crisil Ltd. Commenced operations on January 1, 1988.
- It offered its share capital to public in 1993.SIL is the only rating agency to operate on the basis of a sectorial specialization, which underpins the sharpness of analysis, responsiveness of the process and large-scale dissemination of opinion pieces.

Crisil ltd.

- CRISIL has rated over 11,026 debt instruments worth Rs.22.52 trillion (over USD453.76 billion)* issued by over 5,716 debt issuers, including manufacturing companies, banks, financial institutions (FIs), state governments and municipal corporations.
- CRISIL Ratings is a full service rating agency that offers a comprehensive range of rating services.

ICRA Ltd.

- Investment Information and Credit Rating Agency of India (ICRA) Ltd.
- The ICRA Ltd has been promoted by the IFCI ltd.
- It started its operations in 1991.
- The primary objectives of ICRA is to rate credit instruments/ debt obligations, to award a grade in consonance with the risk associated with them, to reflect the relative capability of timely servicing of the obligations.
- ICRA has ventured into Earnings Prospects and Risk Analysis (EPRA).

ICRA Ltd.

- **Rating & Grading services.**

- **Credit Assessment:**
- Icra takes up a assignments for credit assessment of companies/undertakings intending to use the same for obtaining specific line of assistance form commercial banks, financial/ investment institutions, factoring companies and financial services companies.

- **General Assessment:**
- Icra provides services of general assessment.
- At the request of banks or any other potential users, it prepares as per their requirements a general assessment report.

Care Ltd.

- Credit Analysis and Research (CARE) Ltd.
- The Credit Analysis and Research Ltd. (Care) is a credit rating and information services company promoted by the Industrial Development Bank Of India (IDBI) jointly with investment institutions, banks and finance companies.
- It commenced its credit rating operations in October 1993.
- CARE's Credit Rating is an opinion on the relative ability and willingness of an issuer to make timely payments on specific debt or related obligations over the life of the instrument.

CARE LTD.

- Credit Analysis & Research Ltd. (CARE Ratings) is a full service rating company that offers a wide range of **rating and grading services** across sectors.
- CARE Ratings methodologies are in line with the best international practices. CARE Ratings has completed over 4677 rating assignments having aggregate value of about Rs 12699 billion (as at June 2008), since its inception in April 1993.
- CARE is recognised by Securities and Exchange Board of India (Sebi), Government of India (GoI) and Reserve Bank of India (RBI) etc.

Onicra Ltd.

- ONIDA INDIVIDUAL CREDIT RATING AGENCY OF INDIA (ONICRA) LTD.
- **ONICRA, being the first to introduce the concept of individual credit rating**, has conducted in-depth, research into all aspects of the behavior of credit seekers and has developed comprehensive rating systems for various types of credit extension.
- It is sponsored by the Onida Finance Ltd (OFL).
- These systems take into account and analyze a vast range of parameters, which have been found to influence an individual's credit behavior

ONICRA LTD.

- It is the first rating agency in India which seeks to rate the credit worthiness of non corporate/individual borrowers.
- Its concept of rating not of the individual but of the risk associated with entering into a transaction with an individual at a particular point of tine
- Its benefit is that the user of the rating is able to measure the credit risk involved and consequently assess the default rate.

Onicra Ltd.

- **Process:**
- Unlike corporate, an individual cannot approach Onicra directly.
- It is the finance firm that insists on its customer obtaining an individual credit rating to reduce its risk exposure.

Criteria for Credit Rating Of Manufacturing Industry

1. Business risk :-
   1. Industry risk
   2. Government policy
   3. Market position
   4. Operating efficiency
   5. Technology
   6. Human resource
   7. Research and Development
2. Financial risk :-
   1. Accounting quality
   2. Adequacy of cash flows
   3. Financial flexibility
3. Management risk analysis.
4. Project risk analysis.

Criteria for Credit Rating of Auto ancillary companies

1. Market position:-
   1. Customer base
   2. Presence in the Auto Mobile and export
2. Operating efficiency
3. Financial risk analysis

Criteria for Credit Rating of For banks and financial institute

- Capital adequacy
- Resource- rising ability
- Asset quality
- Management and systems evaluation
- Earnings potential
- Liquidity

Venture capital

Introduction

- The term ‘Venture capital’ comprises of two words viz., ‘Venture’ and ‘Capital’.
- The dictionary meaning of ‘venture’ is a course of proceeding associated with risk, the outcome of which is uncertain and ‘capital’ means resources to start the enterprise.
- In a narrower sense venture capital is understood as the capital which is available for financing new venture.
- Broadly, it can be interpreted as the investment of long-term equity finance where the venture capitalist earns has return from capital gain.

Concept of Venture Capital

- venture capital can be defined as the long-term equity investments in business which display potential for significant growth and financial return.
- The nature of financing i.e. long-term equity, implies that the investor bears the risk of venture, but would earn a return commensurate with its success.
- Thus, the return for the investor is not through a steady dividend or interest yield but through capital gain.

Contd.

- Above definition incorporates the three main features that distinguishes venture capital investment from other forms of capital investment. They are:

1. *Supporting* entrepreneurial talent by providing finance
2. Providing business management skills
3. A return in the form of capital gains.

Introduction

- The venture capital investment help for the growth of innovative entrepreneurship in India
- Venture capital means risk capital
- The risk envisaged may be very high may be so high as to result in total loss or very less so as to result in high gains

Concept of venture capital

- Venture economics defines venture capital as "providing seed, start up and first stage financing" and also funding the expansion of companies that have already demonstrated their business potential but do not yet have access to the public securities market or to credit oriented institutional funding sources

Difference for traditional capital

Venture capital

1. Less fluid
2. Requires high return rate
3. Invested based on long run future
4. Concerned with product and market potential
5. Ventures capitalist and partner are co owners

Traditional capital

1. More fluid
2. Bears lower return rate
3. Invested based on immediate future
4. Concerned with past performance
5. Loaning bank is creditor

Venture capital in India

- In India Venture Capital plays a vital role in the development and growth of innovative entrepreneurships
- Venture Capital activity in the past was possibly done by the developmental financial instructions like IDBI, ICICI and state financial corporations

Concept

- Venture capital is a private equity investment in entrepreneurial companies used to finance the working capital requirement and asset needs of growing businesses.

Venture Capital Funds generally:

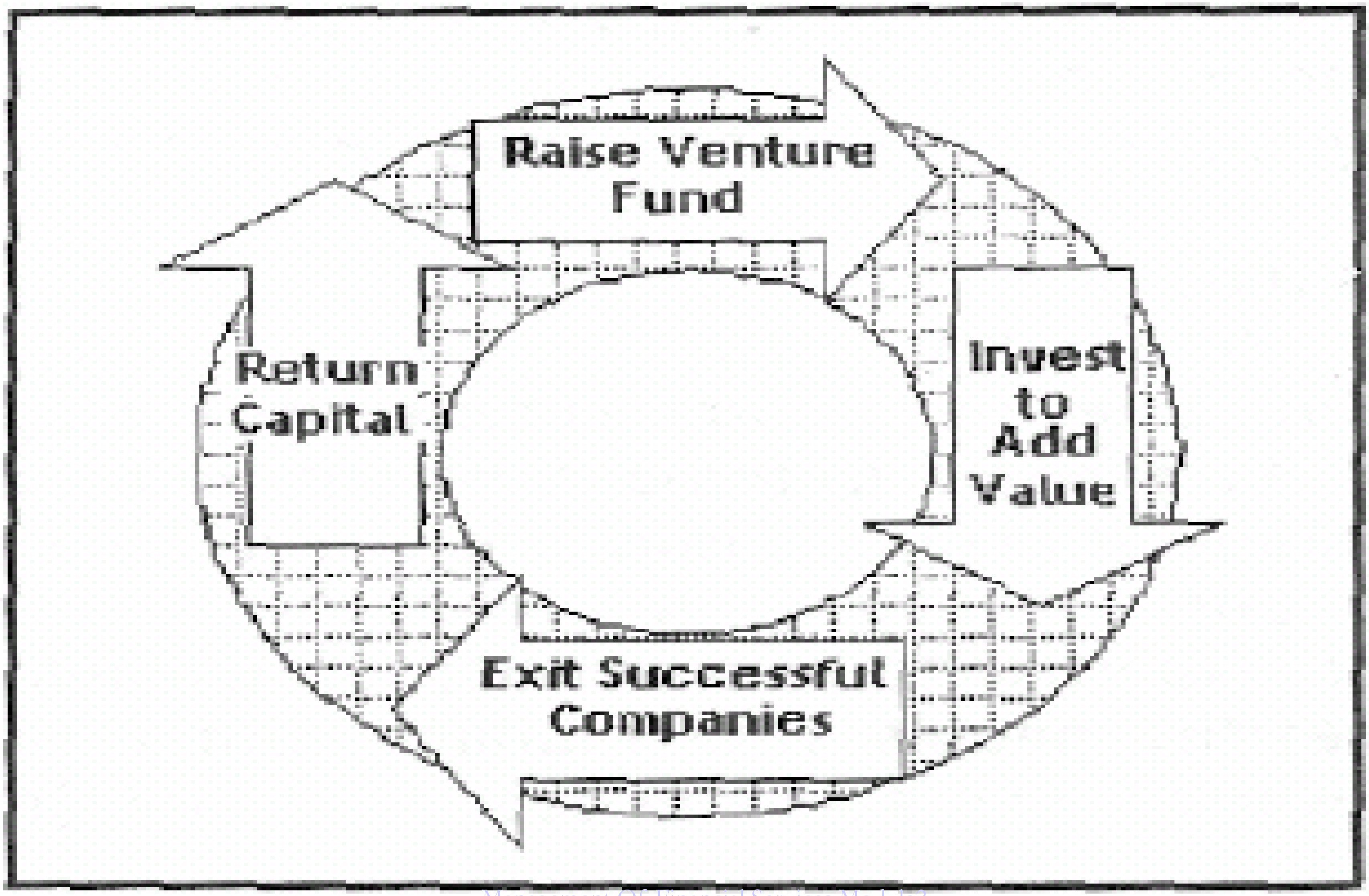
1. Finance new and rapidly growing companies;
2. Invest in typically knowledge-based, sustainable, up-scaleable companies;
3. Purchase equity or quasi-equity securities;
4. Assist in the development of new products or services;
5. Add value to the company through active participation;
6. Take higher risks with the expectation of higher rewards;
7. Have a long-term orientation.

Mechanism of Venture Capital

- The flow of venture capital from the investor to a Start-up Company and back can be thought of as a cycle that runs through several phases.

1. Raising of venture fund.
2. Investing in, monitoring of, adding value to firms.
3. Exiting successful companies; returning capital to investors.

Mechanism of Venture Capital



Types of Venture Capitalists

(1) **Generalist:** Generalist Category and Venture Capitalists are who invest in various industries/sectors/geographi locations/various stages of company life cycle

(2) **Specialist:** Invest in one or two industries or sectors or may seek to invest in only a particular geographic area

Benefits of Venture Capital

1. Venture backed companies have been shown to grow faster than other types of companies. This is made possible by the provision of a combination of capital and experienced personal input from venture capital executives, which sets it apart from other forms of finance.
2. Venture capital can help you achieve your ambitions for your company and provide a stable base for strategic decision making.
3. The venture capital firms will seek to increase a company's value to its owners, without taking day-to-day management control. Although you may have a smaller "slice of cake", within a few years your "slice" should be worth considerably more than the whole "cake" was to you before.
4. Venture capital firms often work in conjunction with other providers of finance and may be able to help you to put a tats funding package together for your business.

Venture Capital Funding :

1. **Start up:** product development and initial marketing
2. **First stage:** establishment of product or service in commercial use and generation of early sales
3. **Second stage:** operational expansion coverage for a company with a growing sales
4. **Third stage:** funding for major expansion of profitable company or bridge financing for a firm expecting to soon go public
5. **Acquisition / by out:** financing for purchase of a business for companies or management teams

Seed money stage: Small amount of financing needed to prove a concept or develop a product. Marketing is not included in this stage.

Start up: Financing for a firm that started up in the past one year. Funds are likely to pay for marketing and Product development.

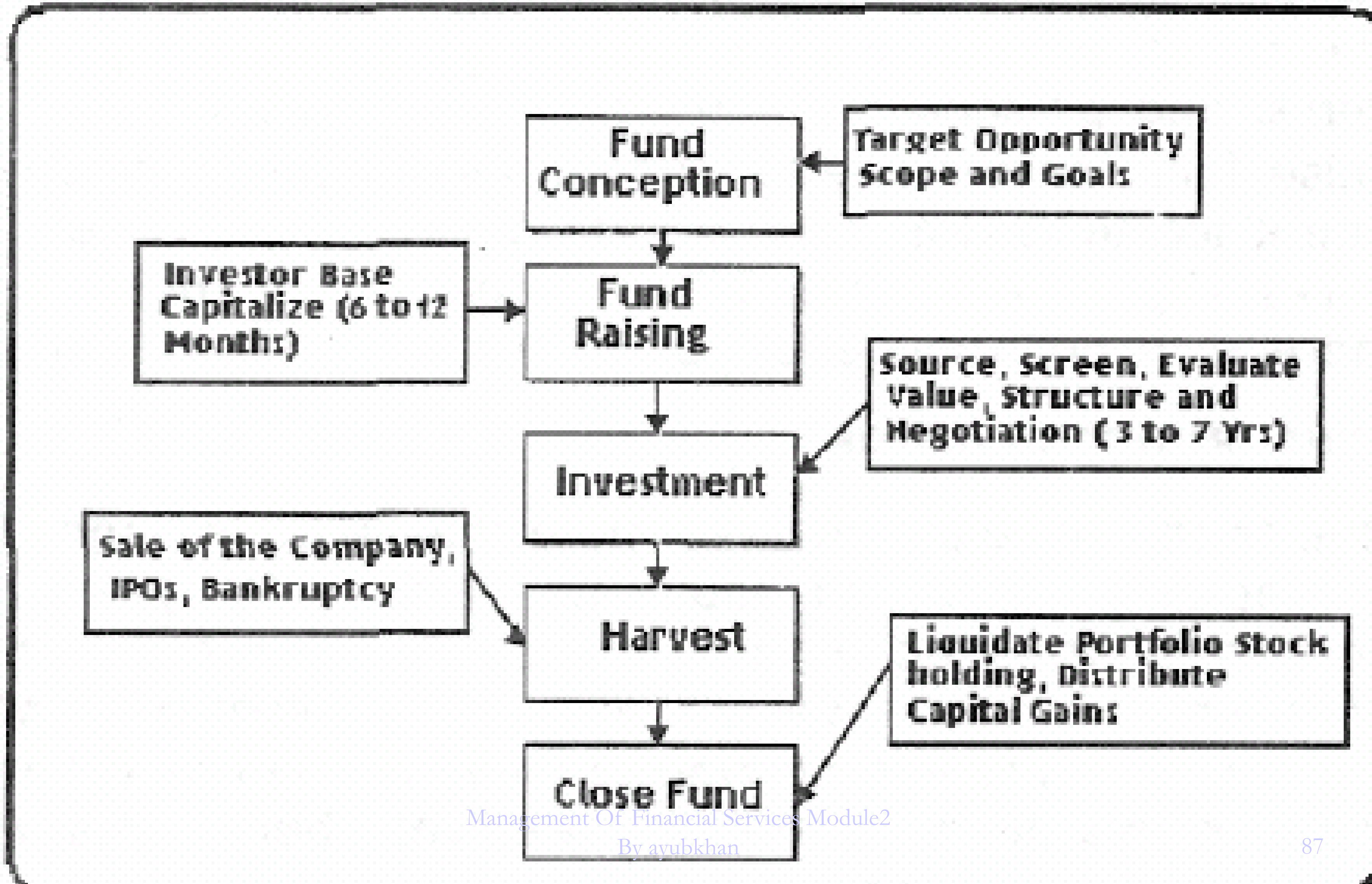
First-round financing: Additional money to begin sales and manufacturing after a firm has spent its start-up capital

Second-round financing: Funds earmarked for working capital for a firm that is selling its product, but is still losing money

Third-round financing: Financing for a firm that is breaking even and is contemplating an expansion project.

Fourth-round financing: Money provided for firms that are likely to go public soon. Also known as bridge financing.

Venture Capital Fund Stages



Problems With Venture Capital in India

1. License
2. Scalability
3. Valuation
4. Mindsets
5. Enforceability
6. Exit
7. Returns, Taxes and Regulations

Important Players

1. Risk capital Technology Finance Corporation Ltd. (RCTC) (Subsidiary of IFCI)
2. Venture Capital Fund (Set up under long-term fiscal policy of Government of India)
3. Technology Development and Information Company of India (TDICI) (Promoted by ICICI and UTI)
4. Indus Venture Capital Fund (Private venture capital fund)
5. Gujarat Venture Finance Ltd. (GVFL) (promoted by Gujarat Industrial Investment Corporation, IDBI, World Bank, SFLS and Private Bodies)

Contd.

6. Credit Capital Venture Fund (Promoted by International Financial Agencies)
7. State Bank Venture Capital Fund (Promoted by SBI Merchant Banking subsidiary and SBI Capital Market)
8. Can Bank Venture Capital Fund (Promoted by Canara Bank)
9. Grindlays Bank Venture Capital Fund (Promoted by Grindlays Bank)
10. SPIDC Venture Capital Ltd. (Promoted by Andhra Pradesh Industrial Development Corporation Ltd.)

Venture capital funds in India

VCFs in India can be categorized into following five groups:

1) Those promoted by the Central Government controlled development finance institutions. For example:

1. ICICI Venture Funds Ltd.
2. IFCI Venture Capital Funds Ltd (IVCF)
3. SIDBI Venture Capital Ltd (SVCL)

2) Those promoted by State Government controlled development finance institutions.

For example:

- Punjab Infotech Venture Fund
- Gujarat Venture Finance Ltd (GVFL)
- Kerala Venture Capital Fund Pvt Ltd.

3) Those promoted by public banks.

For example:

- Canbank Venture Capital Fund
- SBI Capital Market Ltd

4)Those promoted by private sector companies.
For example:
- IL&FS Trust Company Ltd
- Infinity Venture India Fund

5)Those established as an overseas venture capital fund.
For example:
- Walden International Investment Group
- HSBC Private Equity management Mauritius Ltd

Rules & regulations of VC in India

- AS PER SEBI
- AS PER INCOME TAX ACT,1961

Conclusion :

- Conclusion Venture Capital Business has been drastically decreasing due to many reasons.
- Liberalize the stringent policies and pave the way to the venture capital investors

Mutual Funds

Introduction

- A mutual fund is an investment company or trust that pools the resources from potential returns and reasonable safety thousands of its shareholders or unit holders who share common investment goal and then diversifies its investments into different types of securities in order to provide

Introduction

- Mutual funds help the small and medium size investors to participate in today's complex and modern financial scenario. Investors can participate in the mutual fund by buying the units of the fund. The income earned through these investments and capital appreciation realized by the schemes is shared by its unit holders in proportion to the number of units owned by them.

SEBI defines MF as under:

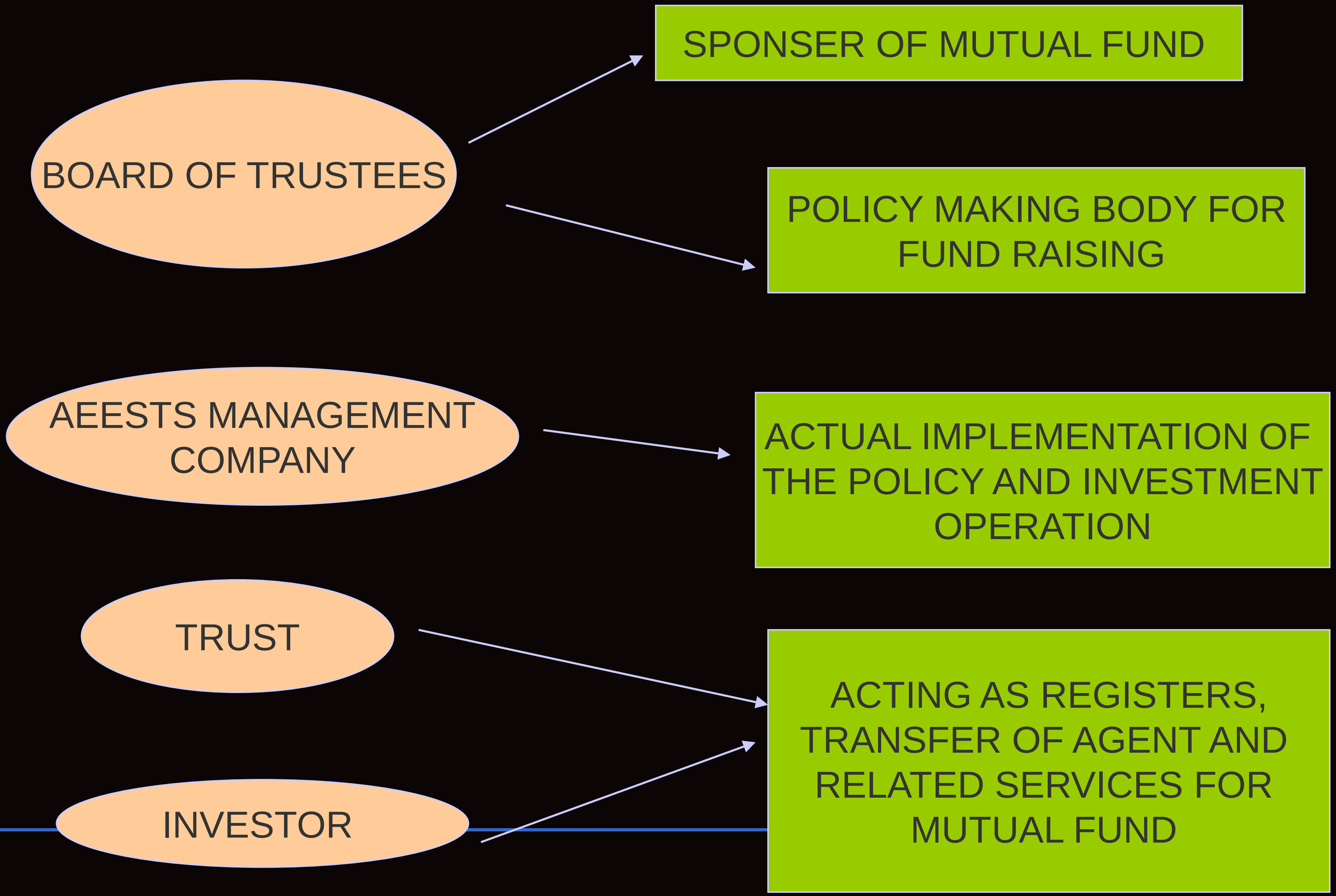
A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. Anybody with an investible surplus of as little as a few thousand rupees can invest in Mutual Funds. These investors buy units of a particular Mutual Fund scheme that has a defined investment objective and strategy. The money thus collected is then invested by the fund manager in different types of securities. These could range from shares to debentures to money market instruments, depending upon the scheme's stated objectives.

Organization Structure of Indian Mutual Funds

There are four constituents of a mutual fund in India,

1. The Sponsor,
2. The Board of Trustees or Trustee Company,
3. The Asset Management Company and
4. The Custodian.

MUTUAL FUND


BOARD OF TRUSTEES
SPONSER OF MUTUAL FUND
POLICY MAKING BODY FOR FUND RAISING
AEESTS MANAGEMENT COMPANY
ACTUAL IMPLEMENTATION OF THE POLICY AND INVESTMENT OPERATION
TRUST
INVESTOR
ACTING AS REGISTERS, TRANSFER OF AGENT AND RELATED SERVICES FOR MUTUAL FUND

Mutual fund, fund structure

In USA mutual funds are investment companies. In UK, its units trust or investment trusts. In India follow the same like UK and only units trust

A) Sponsor :

- appoints board of trustees, AMC, custodian
- Qualification
  - Contribution 40% net worth of AMC
  - Should have firm financial track record for 5 years
  - Hands over trust deed to trustees

B) Trustees : (under the Indian trustees act)

- investments are held by them in given trust capacity
- AMC appoints with prior approval of SEBI
- Right to dismiss AMC with SEBI approval
- Reserves fees for services
- Must furnish half – yearly reports to SEBI on fund activities

Mutual fund, fund structure

C) ASSETS MANAGEMENT COMPANY (AMC)

- AMCs are fund managers
- Should have a net worth of Rs. 10 cr all the time
- Can’t ACT as C trustees of any other mutual fund
- Answerable to trustees and needs to submit quarterly report to SEBI on activities.
- Must comply with SEBI regulation.

D) Custodian

Appointed by board of trustees for safe keeping securities as independent entity of sponsors.

E) Transfer Agents

Issue and redeem units and other related services such as preparation of transfer documents and updating investors records

Origin and Growth of Mutual Fund in India

In India, the Mutual Fund industry started with the setting up of Unit Trust of India in 1964, as a single State Monopoly. Twenty-three years later Public Sector banks and financial institutions were permitted to establish Mutual Funds in 1987. The Industry was brought under the control of SEBI and opened for private sector participation in 1993.

Growth and Development of Mutual Funds in India

- The Indian mutual fund industry has evolved over distinct stages. The growth of the mutual fund industry in India can be divided into four phases:
- Phase I (1964-87),
- Phase II (1987-92),
- Phase III (1992-97), and
- Phase IV (beyond 1997).

Phases of Mutual Fund

- Phase I:
  - The mutual fund concept was introduced in India with the setting up of UTI in 1963. The Unit Trust of India (UTI) was the first mutual fund set up under UTI Act, 1963, a special act of the parliament. It became operational in 1964 with a major objective of mobilizing savings through the sale of units and investing them in corporate securities for maximizing yield and capital appreciation.

Phases of Mutual Fund cont..

- Phase II:
  - The second phase witnesses the entry of mutual fund companies sponsored by nationalized banks and insurance companies.

Phases of Mutual Fund cont..

- Phase III:
  - The year 1993 marked a turning point in the history of mutual funds in India. The Securities and Exchange Board of India (SEBI) issued the Mutual Fund Regulations in January 1993. SEBI notified regulations bringing all mutual funds except UTI under a common regulatory framework. Private domestic and foreign players were allowed entry in the mutual fund industry.

Phases of Mutual Fund cont..

- Phase IV:
- During this phase, the flow of funds into the kitty of mutual funds sharply increased. This significant growth was aided by a more positive sentiment in the capital market, significant tax benefits, and improvement in the quality of investor service.

Types of Mutual Fund Schemes

The objectives of mutual funds are to provide continuous liquidity and higher yields with high degree of safety to investors. Based on these objectives, different types of mutual fund schemes have evolved.

Types of Mutual Fund Schemes

Functional	Portfolio	Geographical	Other
1. Open-Ended Schemes 2. Close-Ended Schemes 3. Interval Schemes	1. Income Funds 2. Growth Funds 3. Balanced Funds 4. Money Market Mutual Funds	1. Domestic 2. Off-shore	1. Sectorial Specific 2. Tax Saving 3. ELSS 4. Special 5. Gilt Funds 6. Load Funds 7. Index Funds 8. ETFs

1. Open-Ended Schemes

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices, which are declared on a daily basis. The key feature of open-end schemes is liquidity.

Close-Ended Schemes

A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors,

Interval Scheme

Interval scheme combines the features of open-ended and close-ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

Portfolio Classification

Here, classification is on the basis of nature and types of securities and objective of investment.

Income Funds

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets.

Growth Funds

The aim of growth funds is to provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences.

Balanced Funds

The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments.

Money Market Mutual Funds

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

Geographical Classification

Domestic Funds

Funds, which mobilize resources from a particular geographical locality like a country or region, are domestic funds. The market is limited and confined to the boundaries of a nation in which the fund operates. They can invest only in the securities, which are issued and traded in the domestic financial markets. For example, Indian equity funds invest primarily in Indian companies.

Offshore Funds

Offshore funds attract foreign capital for investment in the country of the issuing company. They facilitate cross-border fund flow, which leads to an increase in foreign currency and foreign exchange reserves. Such mutual funds are invested in securities of foreign currency and foreign exchange reserves. Such mutual funds can invest in securities of foreign companies. They open domestic capital market to international investors. Many mutual funds in India have launched a number of offshore funds, either independently or jointly with foreign investment management companies. The first offshore fund, the India Fund, was launched by Unit Trust of India in July 1986 in collaboration with the US fund manager, Merril Lynch.

Others

Sectoral Funds

Sectoral Funds are those, which invest exclusively in a specified industry or a group of industries or various segments such as 'A' Group shares like energy, telecommunications, IT, construction, transportation and financial services.

Tax Saving Schemes

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961. The Act also provides opportunities to investors to save capital gains u/s 54EA and 54EB by investing in Mutual Funds.

Equity-linked Savings Scheme (ELSS)

In order to encourage investors to invest in equity market, the government has given tax-concessions through special schemes. Investment in these schemes entitles the investor to claim an income tax rebate, but these schemes carry a lock-in period before the end of which funds cannot be withdrawn.

Special Schemes

Mutual Funds have launched special schemes to cater to the special needs of investors. UTI has launched special schemes such as Children's Gift Growth Fund, 1986, Housing Unit Scheme, 1992, and Venture Capital Funds.

Gilt Funds

These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as are the case with income or debt oriented schemes.

Index Funds

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error“.

Exchange Traded Funds

Exchange Traded Funds (ETFs) are a hybrid of open-ended mutual funds and listed individual stocks. They are listed on stock exchanges and traded like individual stocks on the stock exchange. However¸ trading at the stock exchanges does not affect their portfolio. ETFs do not sell their shares directly to investors for cash. The shares are offered to investors over the stock exchange. EFTs are basically passively managed funds that track a particular index such as S&P CNX Nifty. Since they are listed on stock exchanges, it is possible to buy and sell them throughout the day and their price is determined by the demand-supply forces in the market.

Investment Objective / Patterns

• Growth	-	Equity
• Income	-	Debt
• Balanced	-	Equity and Debt
• Money Market	-	Liquid debt
• Tax Savings	-	Equity
• Specialized	-	Equity
• Assured Return	-	Equity & Debt

What is offer documents

- Contains the details of schemes
- Filed with SEBI
- Like prospectus of an IPO
- Close ended scheme – one time
- Open ended schemes – perpetual – kept updated from time to time.

NAV = Net Assets of Schemes/No. Of units Outstanding

i.e. market value of the investments + Receivables+other accrued income + other assets – accrued expenses – other payables – other liabilities / No. of units outstanding as at the NAV date.

How NAV is Computed

Market Value of Equity – Rs. 100 crore – Asset

Market value of Debentures – Rs. 50 Crore – Asset

Dividends Accrued – RS. 1 crore – Income

Interest Accrued – Rs. 2 crore – Income

Ongoing fee Payable – Rs. 0.5 Crore – Liability

Amt. Payable on shares purchased – Rs. 4.5 crore – Liability

No. of units held in the fund : 10 crore units

NAV per unit = [(100+50+1+2)-(0.5+4.5)]/10

[153-5]/10

Rs. 14.80

NAV is influenced by

1. Purchase and sale of Investment
2. Valuation of Investment
3. Other assets & liabilities
4. Units sold or redeemed

$$\text{Net Asset Value} = \frac{\begin{array}{c}\text{Market/Fair value of the chosen fund's underlying assets} \\ \text{Plus Current assets, accrued income} \\ \text{(Net of Fund Management charge and other outgo)} \\ \text{less Current Liabilities and Provision}\end{array}}{\text{Numer of units existing in the fund at the valuation date}}$$

Scheme Name : XYZ

Scheme Size : Rs. 50,00,00,000/- (Rupees fifty crores)

Face value of units : Rs. 10/-

No. of units: 5,00,00,000

$$\frac{\text{Scheme size}}{\text{Face value of units}}$$

Investments: In shares

Market value of shares: Rs. 75,00,00,000 (Rupees Seventy five crores)

$$\frac{\text{Scheme size}}{\text{Face value of units}}$$

Thus, each unit of Rs. 10/- is now worth Rs. 15/-.

$$\frac{\text{Market value of investments}}{\text{No. of units}}$$

Change in NAV

Formula:

(NAV at the end of period – NAV at beginning of period)*100 /NAV at beginning of the period

Entry Load or front ended load

Paid at the time of purchase

Sale price = NAV / (1- sales load)

Exit Load or back ended load

Paid at the time of exit

Redemption Price = NAV / (1+exit load)

Benefits to investing in Mutual Funds

1. Professional Management
2. Diversification
3. Convenient Administration
4. Return Potential
5. Low Costs
6. Liquidity
7. Transparency
8. Flexibility
9. Affordability
10. Choice of Schemes
11. Well Regulated

Benefits of Investing in Mutual Funds

1. Professional Management
    1. Mutual Funds provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.
2. Diversification
    1. Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. We achieve this diversification through a Mutual Fund with far less money than we can do on our own.

Benefits of Investing in Mutual Funds

3. Convenient Administration

   Investing in a Mutual Fund reduces paperwork and helps us to avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save our valuable time and make investing easy and convenient

4. Return Potential

   Over a medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities

5. Low Costs

   Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors

Benefits of Investing in Mutual Funds

6. Liquidity
   In open-end schemes, the investor gets the money back promptly at net asset value related prices from the Mutual Fund. In closed-end schemes, the units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.
7. Transparency
   We get regular information on the value of our investment in addition to disclosure on the specific investments made in our scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

Benefits of Investing in Mutual Funds

8. Flexibility
   Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, we can systematically invest or withdraw funds according to our needs and convenience.

9. Affordability
   Investors individually may lack sufficient funds to invest in high-grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy.

Benefits of Investing in Mutual Funds

10. Choice of Schemes

Mutual Funds offer a family of schemes to suit our varying needs over a lifetime.

11. Well Regulated

All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI

Disadvantages Of Mutual Funds

1. No Guarantees
2. Fees and commissions
3. Taxes
4. Management risk

Disadvantages of Mutual Fund

- Mutual funds have their drawbacks and may not be for everyone:

1. No Guarantees

   No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

2. Fees and commissions

All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if you don't use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.

3. Taxes

During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.

4. Management risk

When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers.

Leasing

Leasing - Concept

- A contractual agreement in which a party owning an asset provides the asset for use to the user over a certain period of time in return for periodic payment with or without a further payment
- At the end of the period of contract the assets reverts back to the lessor unless there is a provision for the renewal of the contract

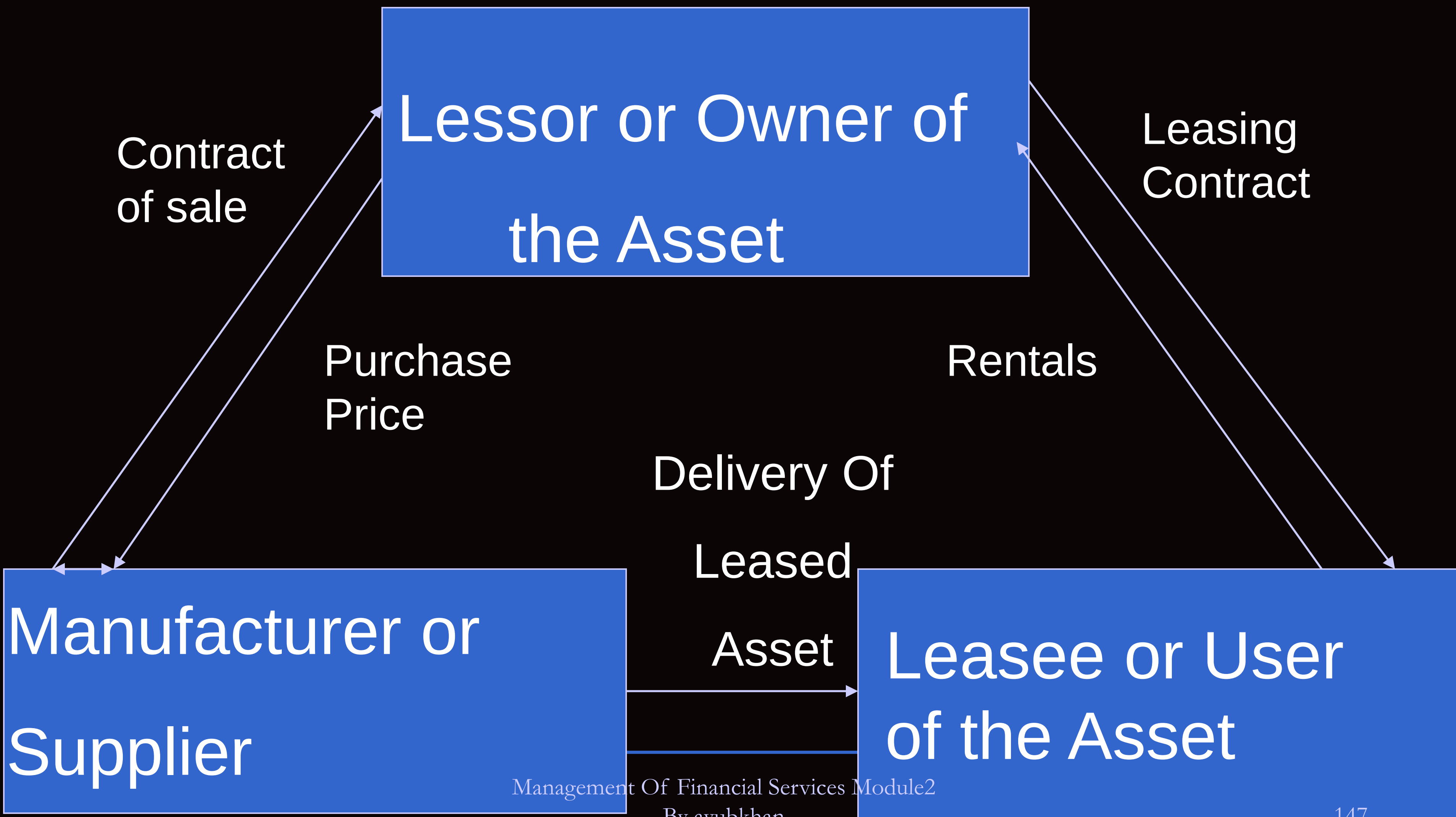
Parties to the contract

- Lessor
  - Lessor is the owner of the asset that is being leased
- Lessee
  - Lessee is the receiver of the services of the asset under a lease contract

Leasing

- It is a process by which a form can obtain the use of a certain fixed asset for which it must make a series of contractual periodic tax-deductible payments(Lease Rentals)

Process of Leasing



Essential elements of Lease

1. Parties to the contract
2. Asset
3. Ownership
4. Term of lease
5. Lease rentals

Modes of Terminating Lease

1. Renewed on a perpetual basis or for a definite period
2. Reverts to lessor
3. Reverts to lessor and lessor sell it to third party
4. Sells asset to lessee

Types of Lease

1. Finance or Capital Lease
2. Operating Lease
3. Sale and Lease back
4. Leveraged Leasing
5. Domestic Lease
6. International Lease

Finance or Capital Lease

- A financial lease is a long term arrangement which is irrevocable during its primary lease period
- It is for terms that approach the economic life of the asset, the total payments over the term of the lease are greater than the lessor's initial cost of the leased asset

Finance or Capital Lease

- In such lease, the lessor is only a financier and is usually not interested in the asset
- For that this lease are also called as FULLY PAYOUT LEASES
- Such lease involved ships, aircrafts, railway wagons, lands, buildings, heavy machinery, diesel generating sets and so on
- According to IAS -17, a financial lease is one which satisfies one or more of the following conditions

conditions

- The lessor transfer title to the lessee at the end of the lease period
- The lease contains an option to purchase the asset at a bargain price
- The lease period is equal to or greater than 75% of the estimated economic life of the asset

conditions

- At the beginning of the lease, the present value of the minimum lease payments equals or exceeds 90% of the fair value of the leased property to the lessor (less any investment, tax credits, realized by the lessor)

Finance or Capital Lease

- In case of capital lease, practically all the risks incidental to the ownership of the asset and the benefits arising there from are transferred to the leasee
- Except the legal title which may or may not be eventually transferred
- The laesee has also to bear costs of insurance, repairs and maintenance of the asset and other related expences

Finance or Capital Lease

- The capital lease is also termed as “close ended lease” since the lease agreement, more or less is irrevocable and the rental payments are so fixed that they ensure return of the total investment at a pre-determined rate of return

Operating Lease

- A lease which dose not satisfy any of the conditions as given above for financial lease is termed as operating lease
- Such a lease agreement gives the lessee the right to use the leased property for a limited period of time
- It dose not give lessee all the benefits and risks that are associated with the asset

Operating Lease

- The lessor is responsible for the maintenance of the asset, insurance and all other relevant expenditure
- It preferred……..
  - Where there is possibility of obsolescence
  - Where the lessee is interested in tiding over a temporary problem

Operating Lease

- It is termed as an “open end lease arrangement” since the lessee has the option to terminate the agreement by notice

Sale and lease back

- A firm sell an asset to another person who in turn lease it back to the firm
- The asset is generally sold at its market value
- The firms receives the sale price in cash and gets the right to use the asset during the basic lease period

Sale and lease back

- The firms make periodic rental payments to the lessor
- The title to the asset now vest with the lessor who is naturally also entitled to any residual value the asset might have at the end of the period
- It is beneficial for both the lessor and lessee

Sale and lease back

- Lesses gets immediate cash which results in improvement in his cash flow position
- The lessor gets the benefits in terms of tax credit due to depreciation
- This options are popular with the companies which facing the problem of short term liquidity

Leveraged leasing

- This form become very popular in recent years
- This is used to financing those assets which require large capital outlays
- Such type of lease arrangement involves three parties LEASEE, LESSOR & LENDER
- Position of lessee under this type of agreement is the same as on case of any other type

Leveraged leasing

- The lesee agrees to make periodic payments over the basic lease period and gets the right to use the asset over the agreed period of time
- The position of lessor undergoes a change
- He acquires the assets as per term of lease arrangement but finances only a part of the total investment say 25%

Leveraged leasing

- The balance of 75% is provided by a person or group of persons in the form of a loan to the lessor
- The loan is generally secured by a mortgage on the asset besides assignment of the leased asset's rental payments

Domestic Lease

- It is a transaction if all parties to the agreement are domiciled in the same country

International Lease

- It is a lease transaction if all parties to the agreement are domiciled in different country

Profile/structure of leasing in india

- Categories of Major players are……
  - Independent leasing companies
  - other finance companies
  - Manufacturer-lessors
  - Financial institutions
  - In-house lessors
  - Commercial banks

Features of lease

- The lease agreement do not provide for transfer of ownership to the lessee as such transactions are classified as hire purchase from the text angle
- The lease rentals are structured so as to recover the entire investment cost during primary period

Features of lease

- The lease rates are determined by a number of factors including the relevant tax, depreciation
- Sale and lease back type of transactions are rare. Most of the lease agreements are financial lease
- Operating lease is also not very popular one

Features of lease

- By and large equipment leases are for capital investments not exceeding Rs. 100 lakh as most lessees view leasing as a kind of stand by finance for meeting unplanned capital expenditure or for acquiring non productive assets such as air conditions and office equipment which are not eligible for assistance by financial intuitions

Significance/advantages of leasing

- To the lessee
  - Financing of capital goods
  - Additional source of finance
  - Less costly
  - Ownership preserved
  - Avoids conditionality
  - Flexibilities in structuring of rentals
  - Simplicity
  - Tax benefits

Significance/advantages of leasing

- To the lessor
  - Full securities
  - Tax benefits
  - High profitability
  - Trading on equity
  - High growth potential

Limitations of Leasing

- Restrictions on use of equipment
- Limitations of financial lease
- Loss of residual value
- Consequences of default
- Understatement of lessee;s asset
- Double sales tax

Accounting Treatment for Leasing

- In the balance sheet the cost price, excluding interest is shown.
- Net book value is cost price less provision for depreciation.

Accounting Treatment for Leasing

- In the profit and loss account the interest for the year is shown together with any depreciation.
- In the balance sheet the liability for future lease payments is shown according to current and long term liabilities. The interest due is not shown as a liability.

Hire Purchase

Meaning

- The hirer has the right to use the asset after payment of a deposit and in return for making regular payments over an interval of time. These are to cover the cost and interest. At the end of the period ownership will usually pass from the finance company to the business.

Meaning

- The asset is shown as a fixed asset since the hirer has sole use of the asset and as long as payments are made the item can be treated as if the business owns the asset.
- In legal terms the business does not own the asset until it exercises the right to purchase.

Hire Purchase

- Apart from consumer vehicles, purchase of consumer articles such as household appliance, air conditioners, refrigerators, office furniture and equipment is financed presently through hire purchase.
- The Indian H.P market is registering a staggering growth rate of around 20% per annum.

H.P. INSTITUTIONS

- The Institutions engaged in the H.P business in organised sector include
- Commercial Banks
- Co-operative Banks
- State Financial Corporations
- National Small Industries Corporations
- In the unorganised sector the comprise a large number of partnership firms and individuals.

FEATURES OF HIRE PURCHASE

- Buyer takes possession of goods immediately and agrees to pay total price in installments.
- Each installment is treated as hire charges
- The ownership of goods passes from the seller to the buyer on the payment of the installment.

FEATURES OF HIRE PURCHASE

- If buyer makes default in the payment of any installment, the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charged

FEATURES OF HIRE PURCHASE

- The hirer has right to terminate the agreement any time before the property passes.

LEGAL POSITION

- The Hire Purchase Act,1972 defines a Hire Purchase as “an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of agreement as under
- 1. Payment is to be made in installments over a specified period.
- 2. The possession is delivered to the purchaser at the time of entering into a contract

LEGAL POSITION

- 3. The property in the goods passes to the purchaser on payment of the last installment.
- 4. Each installment is treated as hire charge so that if default is made in payment of anyone installment, the seller is entitled to take away the goods.
- 5. The hirer/purchaser is free to return the goods without being required to pay further installments falling due after the return

HIRE PURCHASE AGREEMENT

- The description of goods in a manner sufficient to identity them
- The H.P price of the goods
- The date of commencement of the agreement
- The number of installments in which H.P price is to be paid, the amount, and due date

H.P & CREDIT SALE

- Hire purchase is different from Credit Sale
- In credit sale, the ownership and possession is transferred to the purchaser simultaneously.
- In H.P, the ownership remains with the seller until last installment is paid

H.P & INSTALLMENT SALE

- H.P transaction is different from Installment System (I.S).
- In case of I.S the possession and ownership is transferred to the buyer immediately.
- When the buyer stops payment of dues (installments), the seller has no right to re-possess the goods.
- He has the only right to sue the buyer for the non-payment by returning the goods.

Hire Purchase
V/S
Lease

Ownership

- HIRE PURCHASE
- It is transferred on payment of last installment

- LEASING
- It rests with lessor

Depreciation

- <u>HIRE PURCHASE</u>
- The hirer is entitled to claim

- <u>LEASING</u>
- Lessor, not the lessee is entitled to claim

Tax Benefits

- <u>HIRE PURCHASE</u>
- Interest of H.P instalment is tax deductible

- <u>LEASING</u>
- Lease rent is tax deductible

Salvage Value

- HIRE PURCHASE
- It can be claimed by the hirer as he is the owner

- LEASING
- It can be claimed by the lessor & not the lessee

Down Payment

- HIRE PURCHASE
- It is required to the extent of 20 to 25% of margin.

- LEASING
- Not required

Reporting

- <u>HIRE PURCHASE</u>
- In Balance sheet as asset

- <u>LEASING</u>
- Shown in foot note only

Accounting Treatment for Hire Purchase

- The cost of the fixed asset is shown on the balance sheet. The cost shown excludes any interest paid.
- The net book value is the cost less any provision for depreciation.

Accounting Treatment for Hire Purchase

- In the profit and loss account the interest paid during the year is shown, together with any depreciation.
- In the balance sheet the liability for future payments is shown. The liability does not include interest. The short term and long term liabilities are shown separately.

ADVANTAGES OF LEASING

- Permit Alternative use of Funds
- Faster and Cheap Credit
- Flexibility
- Facilitates Additional Borrowings
- Protection against obsolescence
- No Restrictive Covenants
- 100% Financing
- Boon to small Firms
- Floatation Cost
- Well-defined Cost

DISADVANTAGES OF LEASING

- Not Suitable for Project Finance
- No Tax Benefit
- No Advantage of Capital Gain
- High Financing Cost
- Heavy Penalties
- Irregular Rents
- No Protection of Asset
- Absence of Laws

FACTORING

Factor

- The word ‘Factor’ has been derived from the Latin word ‘Facere’ which means **‘to make or to do'**. It means ‘to get things done’.
- According to the Webster Dictionary ‘Factor’ is an agent, as a banking or insurance company, engaged in financing the operations of certain companies or in financing wholesale or retail trade sales, through the purchase of account receivable.

What is Factoring?

- Factoring is nothing but financing through purchase of account receivables.
- Thus, factoring is a method of financing whereby a company sells its trade debts at a discount to a financial institution.
- In other words, factoring is a continuous agreement between a financial institution (factor) & a company (client) which sells goods or services to trade customers on credit.

- According to Robert W. Johnson, “factoring is a service involving the purchase by a financial organisation, called a factor, of receivables owned to manufacturers and distributors by their customers, with the factor assuming full credit and collection responsibilities.”
- Acc. To V.A. Avadhani, “factoring is a service of financial nature involving the conversion of credit bills into cash.”

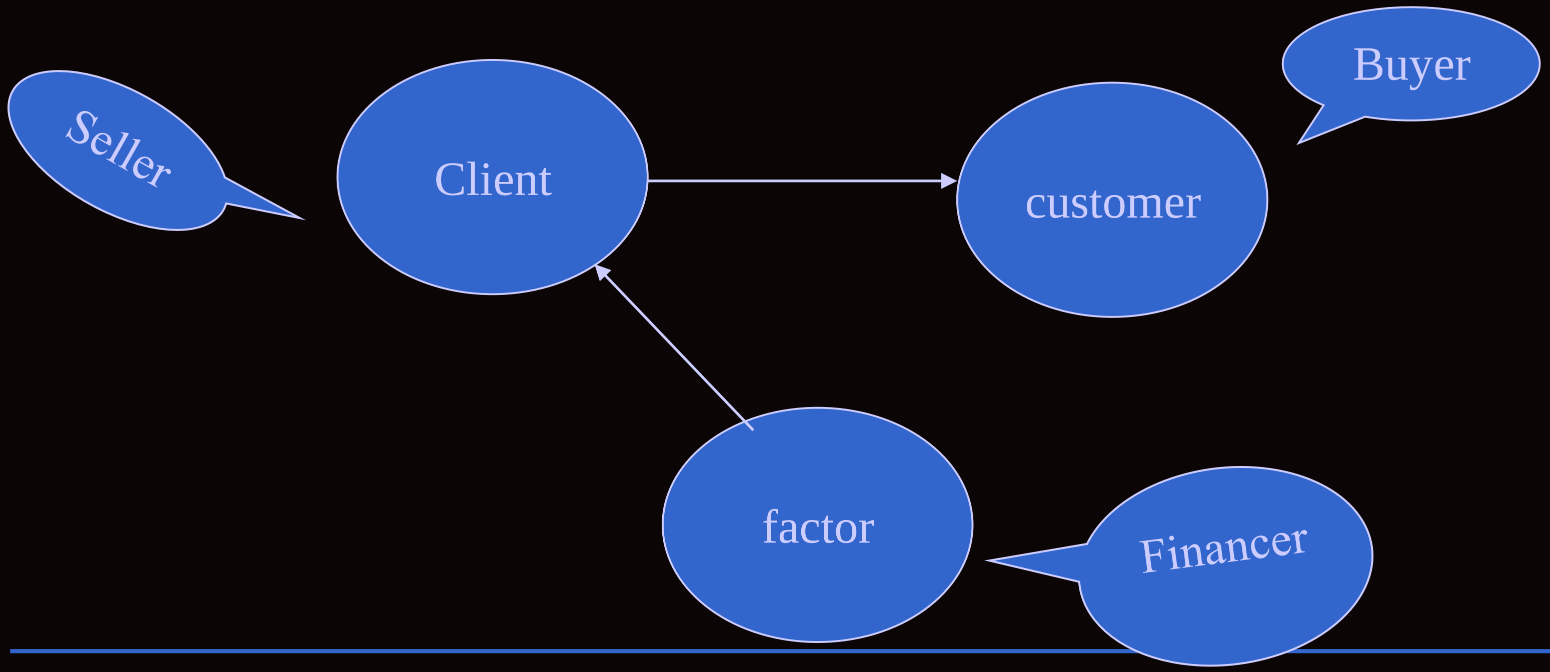
- In the words of Kohak, “ factoring is an asset based means of financing by which the factors buys up the book debts of a company on a regular basis, paying cash down against receivables, and then collects the amounts from the customers to whom the company has supplied goods.”

How it is done?

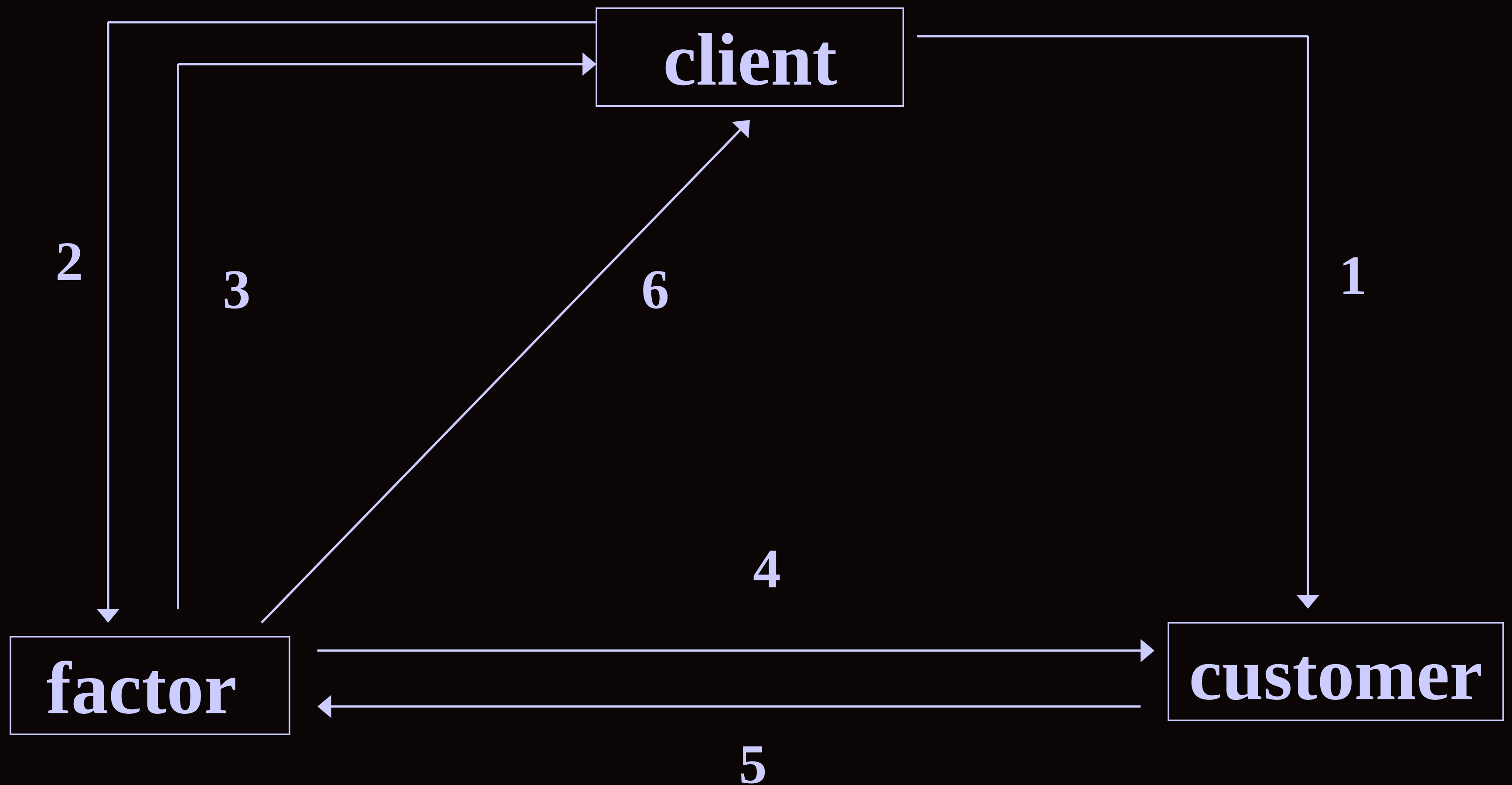
- Factor provides finance to his client up to a certain percentage of the unpaid invoices which represent the sale of goods or services to approved customers.
- There should be Factoring agreement between client and factor.

Parties to factoring services

- Basically there are three parties to the factoring services as depicted below:



Factoring Mechanism



1. Customer places an order with the client for goods or services on credit, client delivers the goods and sends invoice to customers.
2. Client assigns invoice to factor.
3. Factor makes prepayment up to 80% and sends periodical statements.
4. Monthly statement of accounts to customer and follow up.
5. Customer makes payment to factor.
6. Factor makes balance 20% payment on realisation to the client.

Characteristics of factoring

- Usually the **period for factoring is 90 to 150 days**. Some factoring companies allow even more than 150 days.
- Factoring is considered to be a **costly source of finance compared to other** sources of short term borrowings.
- **Bad debts will not be considered** for factoring.

Characteristics of factoring

- Factoring receivables is an ideal financial solution for new and emerging firms without strong financials. This is because **credit worthiness is evaluated based on the financial strength of the customer (debtor).** Hence these companies can leverage on the financial strength of their customers.
- **Credit rating is not mandatory**. But the factoring companies usually carry out credit risk analysis before entering into the agreement.

Characteristics of factoring

- Indian firms offer **factoring for invoices as low as 1000Rs**
- For **delayed payments** beyond the approved credit period, **penal charge of around 1-2% per month** over and above the **normal cost is charged** (it varies like 1% for the first month and 2% afterwards).

Services Provided by Factor

- Credit management & Covering the risk involved.
- Provision of prepayment of funds against the debts it agreed to buy.
- Arrangements for collection of debts.
- Administration of sales ledger.

TYPES OF FACTORING

1. Full service factoring

- A factor provides all kinds of services which include financing, administers the sales ledger, collects the debts at his risk and renders consultancy services.
- Standard factoring.
- If debtors fail to repay the debts, the entire responsibility falls on the shoulders of the factor.
- Factor cannot pass on his responsibility to his client and thus it is also called WITHOUT RECOURSE FACTORING.

2.With recourse factoring

- The factor does not assume credit risk.
- In other words, if the debtors do not repay their dues in time and if their debts are outstanding beyond a fixed period, e.g. 60 to 90 days from due date., such debts are automatically assigned back to the client.
- Either the client has to take up work of collection of overdue account by himself or he has to pay Refactoring charges to Factor to continue with the collection work.

3.Maturity factoring

- The factor does not immediate cash payment to the client at the time of assignment of debts.
- He pays cash as and when collection are made from the debtors.
- The entire amount paid less the factoring fees is immediately paid.
- It is also called COLLECTION FINANCING as there is no financing as such but other services are available.

4. Bulk factoring

- The factor provides finance after disclosing the fact of assignment of debts to the debtors concerned.
- Here factor is not fully satisfied with the financial conditions.
- The factor simply collects the debts on behalf of the client.
- This is also called DISCLOSED FACTORING or NOTIFIED FACTORING.

5. Invoice factoring

- The factor simply provides finance against invoices without undertaking any other functions.
- All other works are performed by client.
- This type of factoring is very confidential in nature and hence CONFIDENTIAL INVOICE FACTORING of UNDISCLSED FACTORING.
- Even customers are also not aware of the financial arrangement.

6. Agency factoring

- The factor and the client share the work between themselves as :

1. The client has to look after the sales ledger administration and collection work.
2. The factor has to provide finance and assume the credit risk.

7. International factoring

- Services are simply extended to international business.

8. Supplier guarantee factoring

- It is suitable for business establishments which sell goods through middlemen.
- The factor guarantees the supplier of goods against invoices raised by the supplier upon another supplier.
- Bills are assigned in favour of the factor who guarantees the payment of bills.

9. Limited factoring

- Factor does not take up all the invoices of a client.
- He discounts only selected invoices on merit basis and converts credit bills into cash in respect of those bills only.

10. Buyer based factoring

- Until now, the factor was working as an agent of the seller.
- But here, the buyer approaches a factor to discount his bills.
- The claims on such buyers are paid by discounting the bills w/o recourse to seller and seller also gets ready cash.
- Facility to only reputed credit buyers.

11. Seller based factoring-

- Here, the seller, instead of discounting his bills, sells all his accounts receivables to the factor after invoicing the customers.
- All documents connected with the sales are handed over to the factor who takes over the remaining functions.
- Facility for reputed and credit worthy sellers.

Factoring v/s Discounting

- Discounting, re-discounting is possible.
- Discounting is an individual transaction in the sense that each bill is separately assessed and discounted. Factoring is a financial service provided by a financial institutions on a whole turnover basis

Factoring v/s Discounting

- In discount each bill has to be individually accepted by a drawee which takes time in factoring a one time notification is taken from the customer at the commencement of the facility

Factoring v/s Discounting

- Discounting involves more paperwork as compare to factoring
- In discounting grace period for payment is usually three days while in case of factoring the grace period is higher
- discounting requires submission of original documents such as bill of landing, challans and invoices while only copies of documents are required in factoring

Cost of factoring/factoring charges

- It of two types of charges namely
  - Finance charges and
  - Service fee

Finance Charges

- Factor pays 80% of the total invoice amount as prepayment so it charges the amount for the same that is finance charge.
- This is normally the same interest rate which is prevailing in the banking system.

Service Charges

- It is a nominal charges levied at monthly intervals to cover the cost of services namely collection, sales ledger management and reports
- It is around 1%.

Discounting Charges

- For providing instant credit to the client by way of prepayments, some charges have to be levied and they are called discount charges.

Accounting System

- Generally, the factoring co. keeps the following accounts to record the factoring transactions:

- **<u>Sales Ledger Control Account:</u> It contains the main asset account of various debtors of clients. It is nothing but the client's debtors account.**

- **Client Current Account:** It is nothing but a statement of account of a client showing all debits and credits.

- **Bank Account:** It is used to record all cash received from debtors of clients and cash paid to the client.

- **<u>Debt Purchase Account:</u>** **This is the replica account of Sales Ledger Control Account. It is also called Master Control Account. Both the accounts depict the same balance.**

Legal Aspects Of Factoring

- A notice of assignment in the prescribed form to all customers, whose receivables have been factored.
- To provide all copies of invoice, challans, and other evidences to the factor.
- The factor requires the power of attorney.
- The legal status of the factor is that of assignee.
- Factoring transactions attract stamp duty to assign all debts.

Advantages of factoring

- To the client (seller)
  - client's credit sales immediately converted into ready cash as the factor makes a payment
  - Client can offer competitive credit terms to his buyers which in turn enable him to increase his sales and profits
  - Client is free from all the administrative work relating to the debts so that able to concentrate on other functions of business

Advantages of factoring

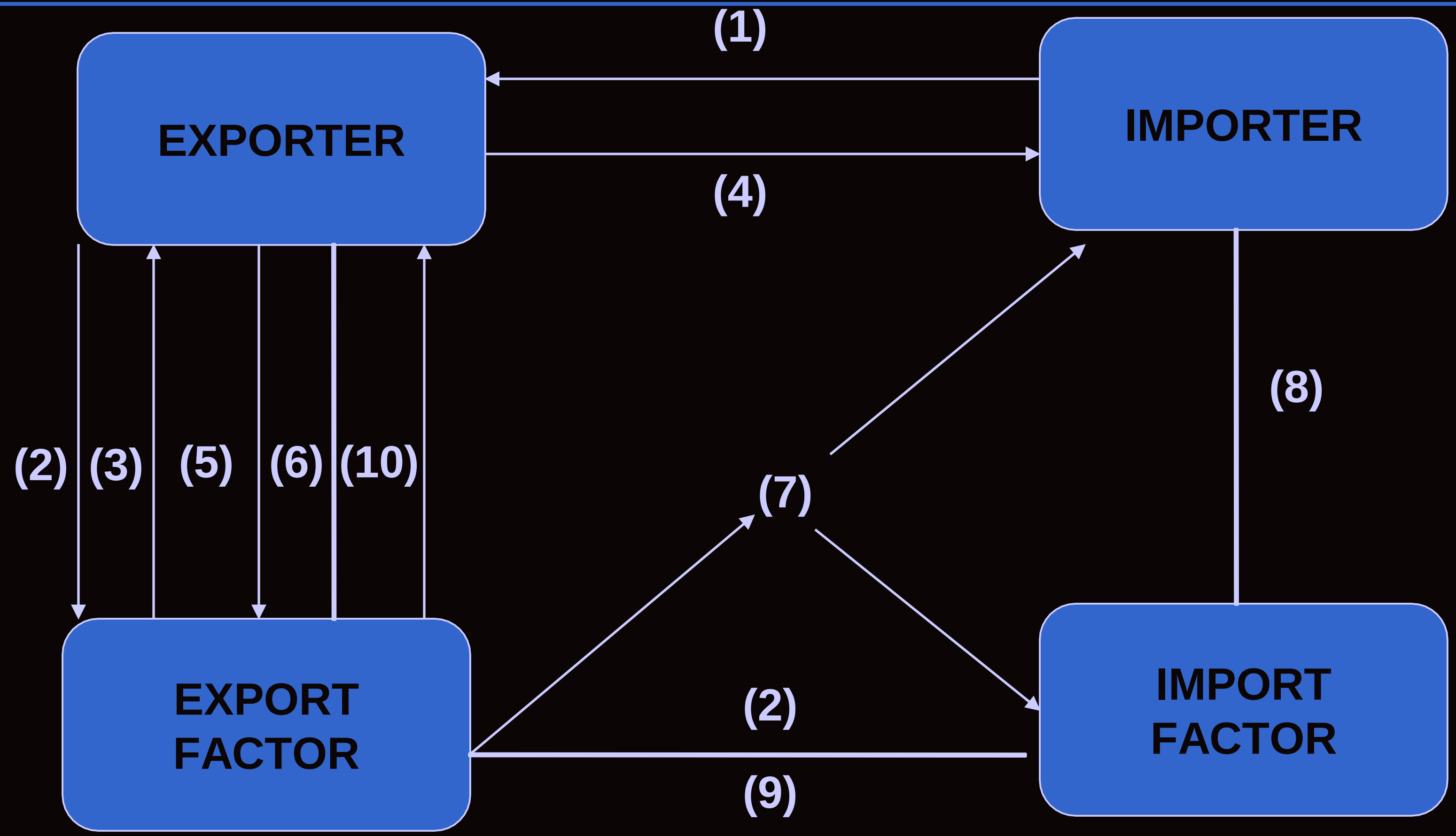
- To the customers (buyers)
  - It facilitate the credit purchases of the customers
  - It improves liquidity of the business

International Factoring

- When the seller and buyer are located in different countries and a factoring agreement takes place it is called international factoring

- In an International factoring transaction, mainly 4 parties are involved.

1. **The Exporter who is taking the place of a client in a domestic transaction.**
2. **The Importer who is taking the role of a customer in a domestic transaction.**
3. **Export Factor (EF) &**
4. **Import Factor (IF)**



(1)Receives order

(2)Credit limit request

(3)Approval

(4)Delivers goods

(5)Submits docs

(6)Prepayment

(7)Documents

(8) Collection

(9) Payment Remittance

(10)Balance Payment

Single Factor System

- Here also 2 Factoring companies are involved.
- But the responsibility of making the payment, maintenance of book of accounts, its administration etc, initially rest with the Export Factor.
- Just to cover credit risk, Export Factor enters into an agreement with the Import Factor.
- The Import Factor assists the Export Factor during the times of difficulties in realizing the debt.
- Just to cover credit risk, Export Factor enters into an agreement with the Import Factor.
- The Import Factor assists the Export Factor during the times of difficulties in realizing the debt.

Direct Export Factor System

- The factoring agreement is directly between the Exporter and the Export Factor and no other party is involved.

Direct Import Factor System

- The factoring agreement is between the Exporter and the Import Factor in the Importer’s country.

Benefits of international factoring

- Exporter deals with only one factor even if his exports are spread across different countries
- He is free form the legal law procedures of that country

FORFAITING

Forfaiting

- The forfaiting owes its origin to a French term 'forfait' which means to forfeit ("to give something" or surrender) one's rights on something to some one else.
- Forfaiting has emerged as an important **instrument of short to long term financing of International Trade**.

Forfaiting

- In trade finance, **forfaiting involves the purchasing of receivables from exporters**. **The forfaiter will take on all the risks involved with the receivables**.
- Forfaiting **is the purchase of a series of credit instruments** such as drafts drawn under time letters of credit, bills of exchange, promissory notes, or other freely negotiable instruments **on a "nonrecourse“ basis** (non-recourse means that there is no comeback on the exporter if the importer does not pay).

Definition

- Forfaiting has been defined as,

"The non-recourse purchase by a bank or any other financial institution, of receivable arising from an export of goods & services."

- The exporter is able to get **100% of the bills minus discount charges immediately** & get the benefit of cash sale.
- The entire responsibility of recovering the amount from the importer rests with the forfaitor.
- **Forfaiting is done without an recourse to the exporter i.e. in case the importer makes a default, the forfaitor cannot go back to the exporter for the recovery of the money.**

Origin Of Forfaiting

- Forfaiting **evolved in 1960**.
- This concept is originally developed to help finance German export to the Eastern countries.
- **In India**, RBI vide its circular AD(GP Service) No.3 dated **February 13, 1992** approved forfaiting as an export financing option.
- **EXIM bank was the first institution** which got approval in 1992 to finance exports through forfaiting.

Working Of Forfaiting

SOME IMPORTANT TERMS:

- The exporter- “the client”
- Financial institution- “the forfaiter”
- The importer- “the debtor”

Forfaiting Process

An exporter, at the time of export of goods & services, approaches a forfaitor and gives him the detailing regarding the contract.

He also discusses the terms & conditions of finance and after all these is acceptable then the sales contract is signed by the exporter and importer than the payment should be made by the importer to the forfaiter.

Cost Of Forfaiting

- Cost of forfaiting finance is always a **fixed rate** of **interest** which is usually included in the face value of the bills or notes.

- The cost of forfaiting varies due to:

- Arrangements duration
- Credit worthiness of the party
- The country where the importer is staying
- The denomination of the currency
- Overall political, economic & monetary conditions prevailing in the country

Forfaiting Process

An exporter, at the time of export of goods & services, approaches a forfaitor and gives him the detailing regarding the contract. He also discusses the terms & conditions of finance and after all these is acceptable then the sales contract is signed by the exporter and importer that the payment should be made by the importer to the forfaiter.

Cost Of Forfaiting

- Cost of forfaiting finance is always a fixed rate of interest which is usually included in the face value of the bills or notes.

- The cost of forfaiting varies due to:

- Arrangements duration
- Credit worthiness of the party
- The country where the importer is staying
- The denomination of the currency
- Overall political, economic & monetary conditions prevailing in the country

Benefits Of Forfaiting

1. **PROFITABLE & LIQUID**

   It is very advantageous from the forfaiter's point of view, as he not only gets immediate income in the form of discount charges, but also, can sell them in the secondary market of or to any investor for cash.

2. **SIMPLE & FLEXIBLE**

   The greatest advantage is its simplicity and flexibility. It can be adopted to any export transaction and the exact structure of finance can also be determined according to the need of the exporter, importer & the forfaiter.

3. **AVOIDS EXPORT CREDIT RISKS**

The exporter is completely free from many export credit risks that may arise due to the possibility of interest fluctuations or exchange rates fluctuations or any political changes that may affect the collection of bills. Forfaiting acts as an insurance against all these risks.

4. **AVOIDS EXPORT CREDIT INSURANCE**

If an exporter goes for forfaiting, he need not purchase any export credit insurance.

5. **CONFIDENTIAL & SPEEDY**

International trade transactions can be carried out very quickly through a forfaitor. It does not involve much documentary procedures and moreover it is very confidential.

6. **SUITABLE TO ALL KINDS OF EXPORT DEALS**

It is suitable to any kind of goods- whether capital goods exports or commodity exports. Any export deal can be subject to forfaiting.

7. **CENT PERCENT FINANCE**

The exporter is able to convert his deferred transaction into cash transaction through a forfaitor. He is able to get 100% finance against export receivables.

8. **FIXED RATE FINANCE**

Forfaiting provides finance always at a fixed rate only. So, there is no need to enter into any hedging transactions to protect against interest rate & exchange rate risk.

Drawbacks Of Forfaiting

1. **NON-AVAILABILITY FOR SHORT & LONG PERIODS**

   It cannot be used for availing short term credit or contracts involving small amounts because they do not give rise to any bills or notes, so, the exporter who require short term & long term credit have to seek some other alternative source.

2. **NON-AVAILABILITY FOR FINANCIALLY WEAK COUNTRIES**

   Forfaiter generally don’t come forward to undertake any forfaiting financing deal involving an importer from a financially weak country.

3. **DOMINANCE OF WESTERN CURRENCIES**

   In international forfaiting, transactions are dominated in leading western currencies like dollar, pound and French & Swiss francs. Hence, our trade contracts have to be in foreign currencies rather than in Indian rupees.

4. DIFFICULTY IN PRUCURING INTERNATIONAL BANK’S GUARANTEE

Forfaiters do not normally finance an export deal unless it is supported by an unconditional and irrevocable guarantee from an international bank known to the forfaitor.

FORFAITING IN INDIA

- In India, forfaiting is slowly emerging as a new product in the liberalized financial market.

- The existing schemes available for exporters like concessional finance by commercial banks, insurance cover against export credit risks by ECGC, Letter of credit (LC), etc. are available mainly to large and well established exporters.

- In this context, forfaiting may be a real boon to the small, as well as new exporters.

- The EXIM Bank was the first institution to get an approval from the Reserve Bank in India to finance exports through forfaiting.
- EXIM Bank & Westdeutsche Landesbank Girozentrale (WestLB), started new company in India to offer factoring and forfaiting to Indian exporters.
- International Finance Corporation (IFC), the Triple 'A' rated private sector arm of the World Bank Group has evinced interest in taking up a stake in the venture and the proposal is under active consideration of IFC.

- The equity sharing arrangement for the new company will be WestLB with 40% stake, Exim Bank 35%, and 25% to be taken up by IFC. Exim Bank's Managing Director will be the Chairman of the new company.

- The minimum value of a forfaiting transaction is Rs. 5,00,000/-. A special form of Pronote / Bill has to be used for forfaiting transactions.

Procedure:

- An Indian exporter will approach the EXIM bank through his bank.
- The EXIM Bank would obtain the forfaiting quotation from the forfaiting agency abroad.
- The exporter would work out his price to be quoted to the importer.
- If the importer accepts the price and the payment terms, the contract would be finalized and executed.

- The exporter would then get cash through forfaiting arrangements for which he has to enter into a separate contract with the forfaiter through the EXIM Bank.

- Thus, the setting up of a new multi-product company offering export factoring and forfaiting under one umbrella will be particularly beneficial to Small and Medium Enterprises (SMEs) exporters who are the backbone of country's exports.

FACTORING vs. FORFAITING

POINTS OF DIFFERENCE	FACTORING	FORFAITING
Extent of Finance	Usually 75 – 80% of the value of the invoice	100% of Invoice value
Credit Worthiness	Factor does the credit rating in case of non-recourse factoring transaction	The Forfaiting Bank relies on the creditability of the Avalling Bank.
Services provided	Day-to-day administration of sales and other allied services	No services are provided
Recourse	With or without recourse	Always without recourse
Sales	By Turnover	By Bills

COMPARATIVE ANALYSIS

	BILLS DISCOUNTED	FACTORING	FORFAITING
1. Scrutiny	Individual Sale Transaction	Service of Sale Transaction	Individual Sale Transaction
2. Extent of Finance	Upto 75 – 80%	Upto 80%	Upto 100%
3. Recourse	With Recourse	With or Without Recourse	Without Recourse
4. Sales Administration	Not Done	Done	Not Done
5. Term	Short Term	Short Term	Medium Term
6. Charge Creation	Hypothecation	Assignment	Assignment

FACTORING V/S BILLS DISCOUNTING

BILL DISCOUNTING

1. Bill is separately examined and discounted.
2. Financial Institution does not have responsibility of Sales Ledger Administration and collection of Debts.
3. No notice of assignment provided to customers of the Client.

FACTORING

1. Pre-payment made against all unpaid and not due invoices purchased by Factor.
2. Factor has responsibility of Sales Ledger Administration and collection of Debts.
3. Notice of assignment is provided to customers of the Client.

FACTORING V/S BILLS DISCOUNTING

BILLS DISCOUNTING

4. Bills discounting is usually done with recourse.
5. Financial Institution can get the bills re-discounted before they mature for payment.

FACTORING

4. Factoring can be done without or without recourse to client. In India, it is done with recourse.
5. Factor cannot re-discount the receivable purchased under advanced factoring arrangement.

Securitization

Definition

SECURITISATION is the process of transforming assets into securities.

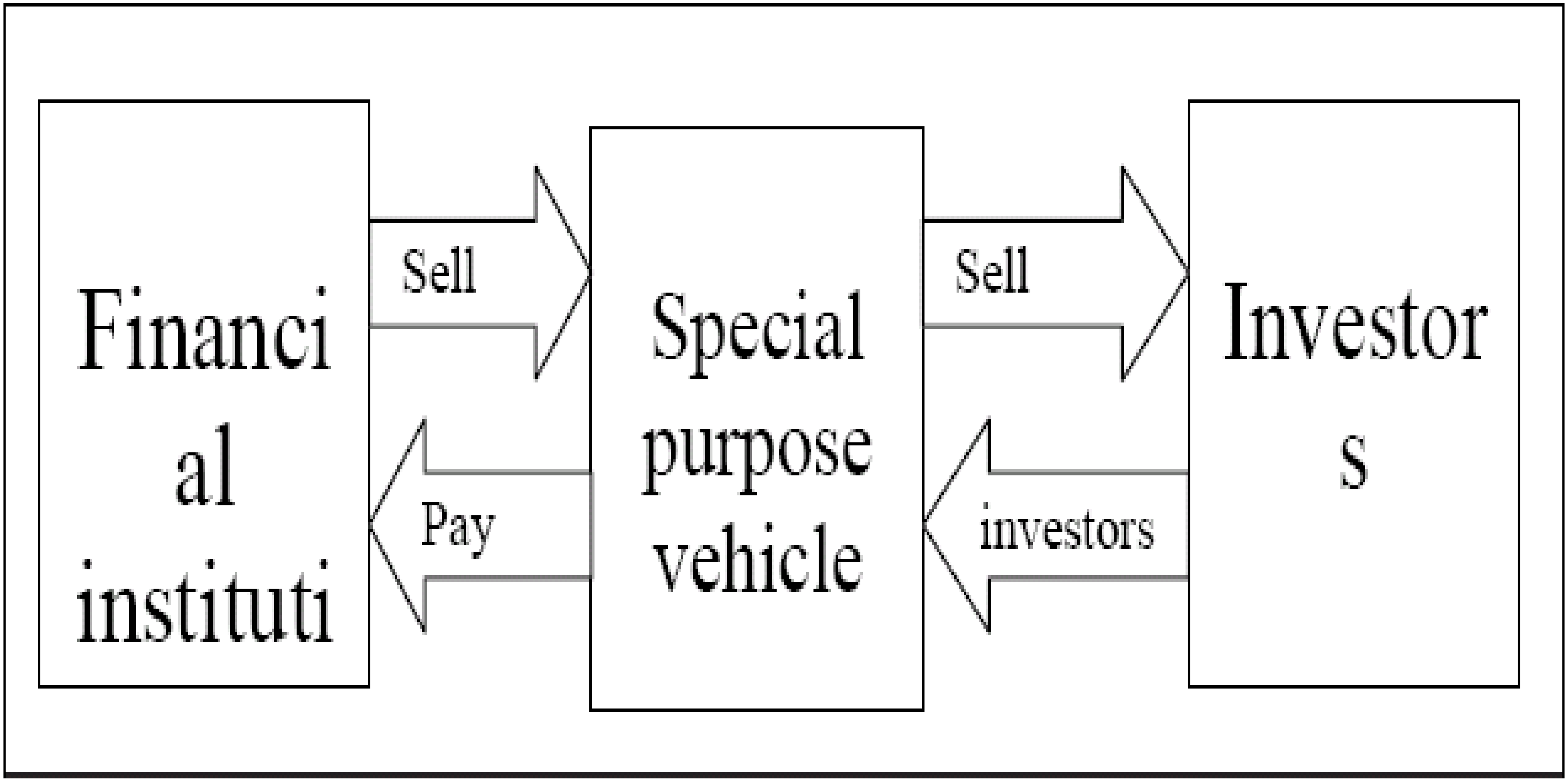
As defined by the recent Ordinance:

"Securitization" means acquisition of financial assets by any securitization company or reconstruction company from any originator, whether by raising of funds by such securitization company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise".

Process of Securitization

1. The SECURITISATION process begins with a financial institution segregating, and then pooling receivables. In the usual a wide variety of asset types are eligible to be pooled.
2. After pooling, a financial institution sells the selected assets to a special-purpose vehicle.
3. This special-purpose vehicle, or SPV, is responsible for both the financial re-engineering of the underlying cash flows and the sale of securities to investors.

Process of Securitization



Reasons for Securitisation

There are three basic reasons why a financial institution wants to securitize assets:

(a) Asset management,

(b) Funding, and

(c) Regulatory performance ratios.

Reasons for Purchasing Securitized Assets

1. Asset diversification,
2. Attractive returns,
3. Safe investments.

Pricing of the Securitization instruments

Pricing of the instrument can be done in two ways.

(a) By Working Forward

This is done by calculating the return to the originator and then deducting the expenses from this return to arrive at the rate to be offered to the investor.

(b) By 'Working Backward

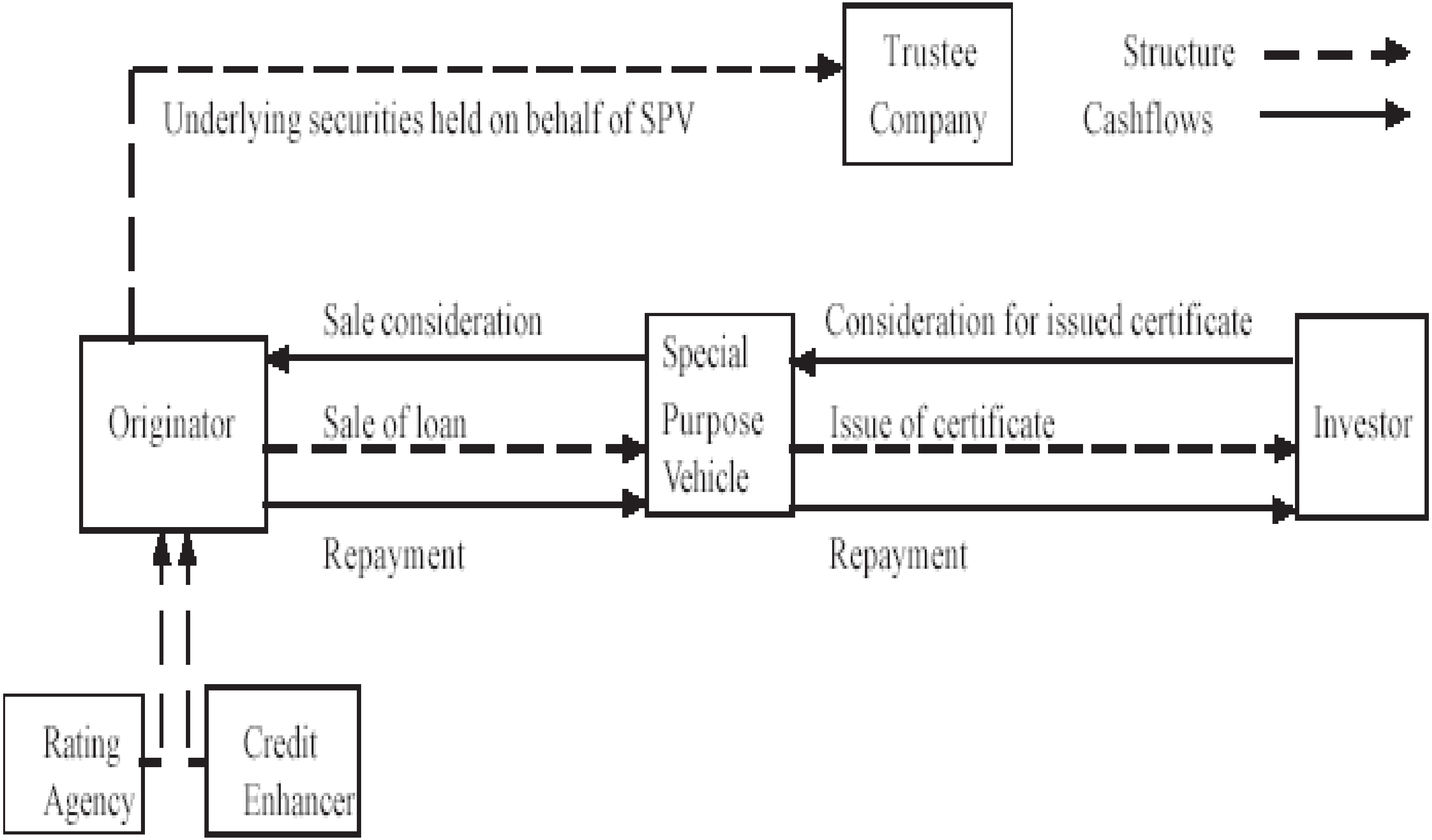
The expectations are taken into consideration and a rate of return to be offered to the investor is arrived at. This should be less than the weighted average rate of return to the organization and the difference will be the spread that the organization will get as profit.

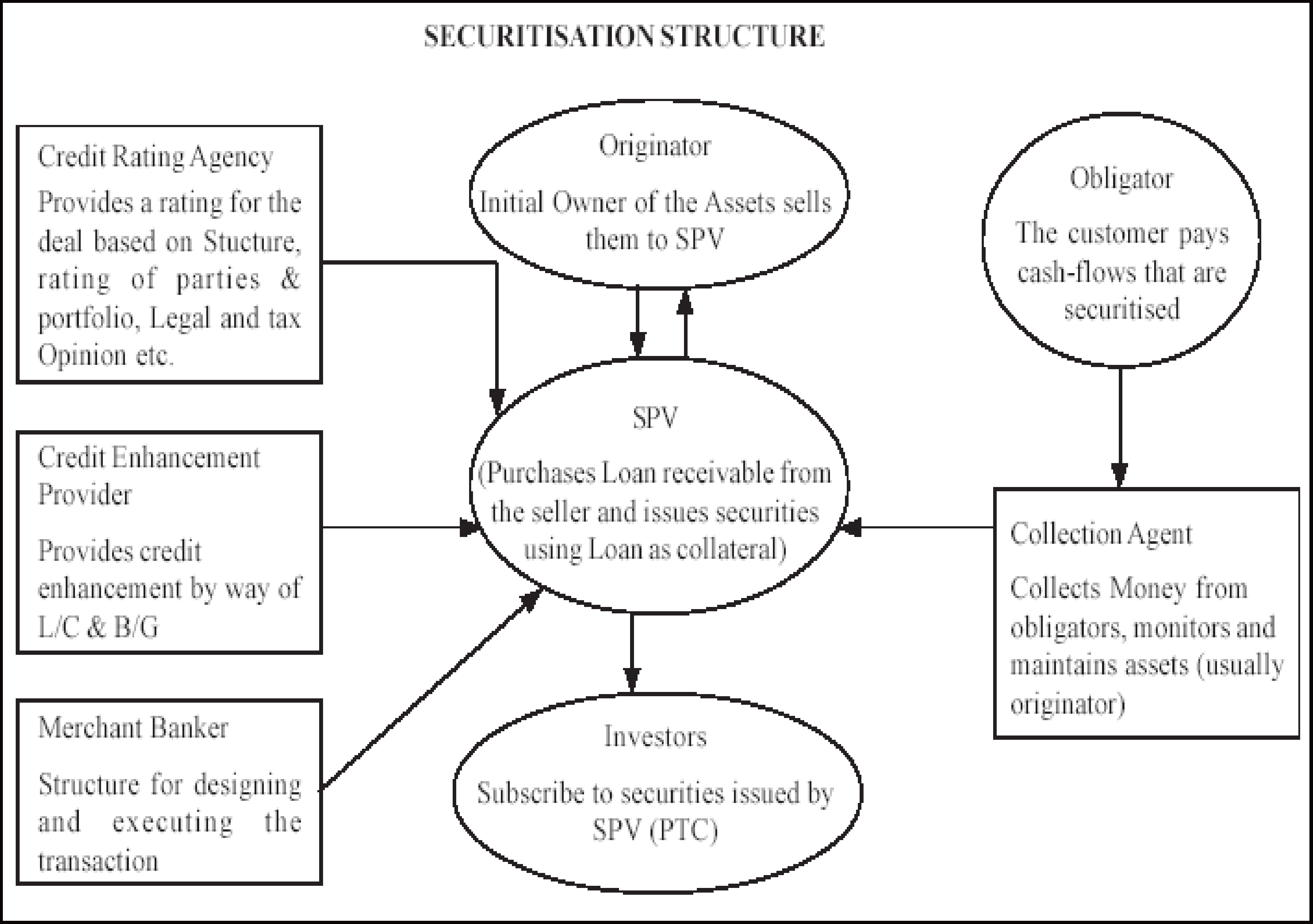
Problems in securitization

Several obstacles are hindering the growth of securitization in India:

- Stamp duty on transfer of assets by originator to the SPV, as high as up to 13%.
- If PTC issued in the form of a receipt, it is not transferable by endorsement and delivery; if PTC is issued in the form of a promissory note it will attract stamp duty.
- Ambiguity on whether PTCs can be regarded as negotiable promissory notes.
- Unresolved tax issues - who will be taxed?
- Weak foreclosure laws failing to provide adequate comfort to investors in ABSs.

STRUCTURE OF A SECURITIES TRANSACTION




SECURITISATION STRUCTURE
Credit Rating Agency
Provides a rating for the deal based on Stucture, rating of parties & portfolio, Legal and tax Opinion etc.
Originator
Initial Owner of the Assets sells them to SPV
Obligator
The customer pays cash-flows that are securitised
SPV
(Purchases Loan receivable from the seller and issues securities using Loan as collateral)
Credit Enhancement Provider
Provides credit enhancement by way of L/C & B/G
Collection Agent
Collects Money from obligators, monitors and maintains assets (usually originator)
Merchant Banker
Structure for designing and executing the transaction
Investors
Subscribe to securities issued by SPV (PTC)

The Why of Securitization (Importance)

1. Companies with low credit rating can issue asset backed securities at lower interest cost due to higher credit rating on such security.
2. Relatively illiquid assets are converted into marketable securities providing liquidity and alternative funding sources.
3. Removal of assets from the balance sheet under a true sale can improve capital adequacy.
4. The operations in a particular business area/portfolio of assets can be increased while not increasing the total exposure to that area or assets.

The Why of Securitization (Importance) cont..

5. Economies of scale are realized as existing capabilities are utilized more fully.
6. In case the originator also acts as the servicer/receiving and paying agent (RPA), it also gets the servicing fee.
7. Spread between the interest rate offered to the investors on the instruments and the interest rate earned on the asset is earned by the originator/issuer.

Securitization How?

Homogeneous loans (asset) are pooled together by Co. A

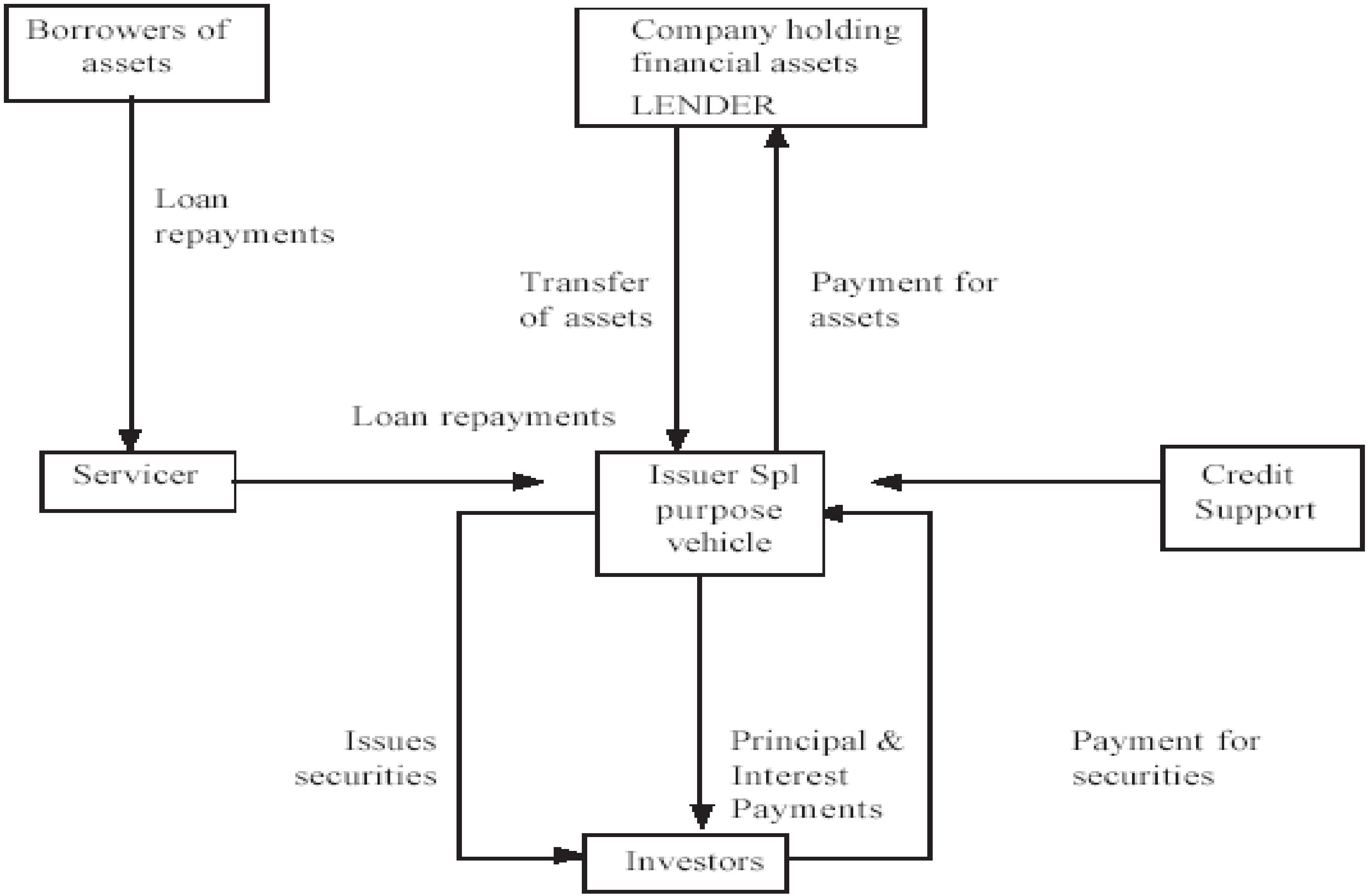
The pool is sold to an SPV (**Special Purpose Vehicle**)

SPV makes a payment to Co. **A at a discount**

SPV issues the Pool certificate to Co. B collecting the sale proceeds and promising to pay Co. B instalment and the interest regularly for a given period of time.

SPV collects the payment from borrowers and passes on the proceeds to Co. B after deducting its service charges.

CASH FLOW STRUCTURE



The Steps in a Securitization Transaction

Step 1 Origination – Lender (FI, Bank, NBFC etc.) makes a loan to a borrower for purchase of an asset (car, property etc.)

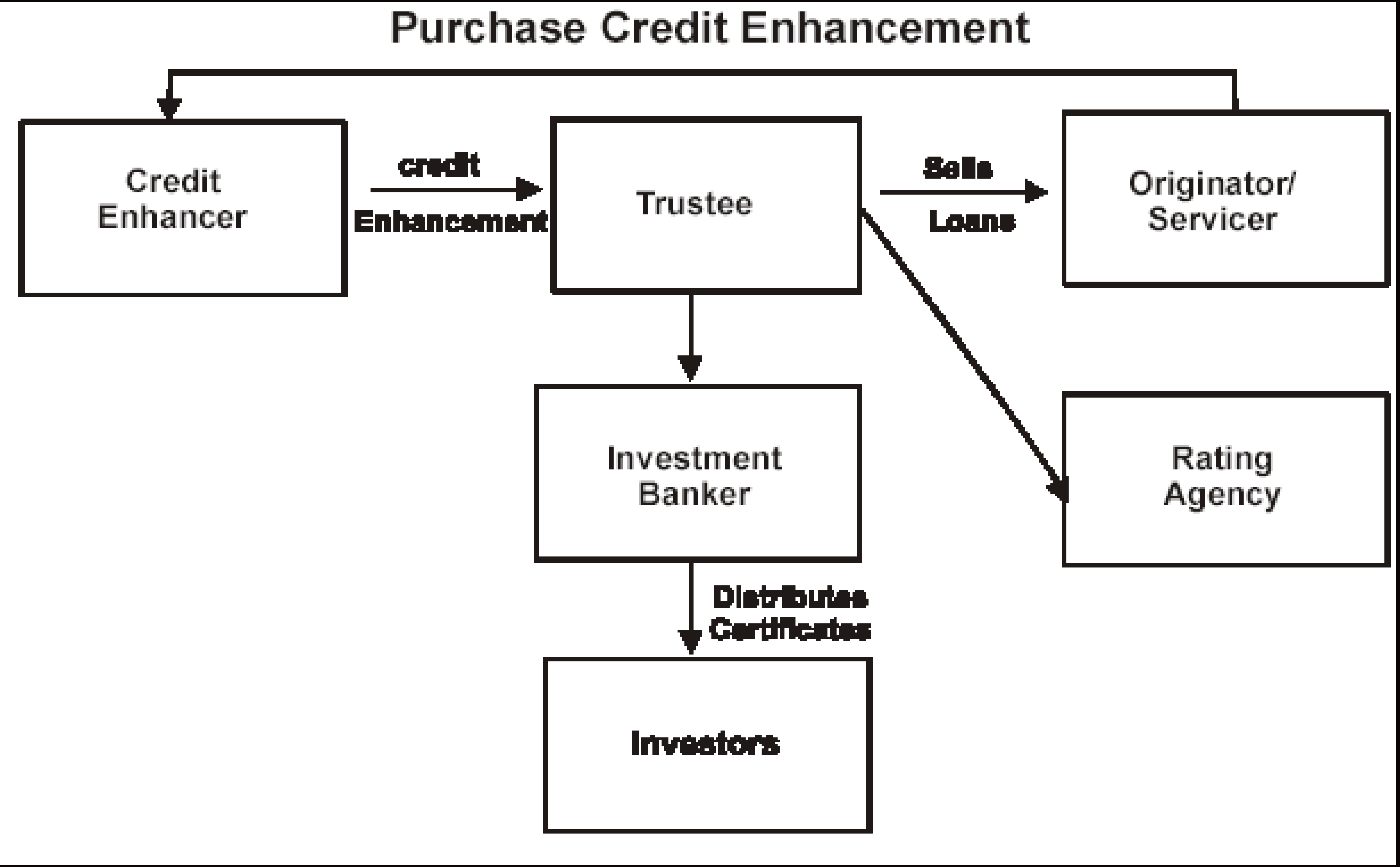
Step 2 Pooling – Large number of homogeneous loans are aggregated or packaged into a pool. The maturities and interest rates of pooled loans are generally the same.

Step 3 Sale/Transfer – (Sale or transfer) of assets from originator to an entity that is generically referred to as a 'Special Purpose Vehicle' or SPV. An SPV may be a trust, a special purpose bankruptcy remote company, or a public sector entity.

Step 4 Credit Enhancement – Protection against the failure of borrowers to make interest and principal payments on the loans. Examples include letter of credit, financial guarantee from a third party, cash collateral, or over-collateralization.

Step 5 Issue of ABS-SPV issues securities to investors and the proceeds from the issuance are used to pay the originator for the pool of loans.

Sale of Assets through pass- through structure



Features of Securitization

1. Most deals have involved the transfer of beneficial interest on the asset and not the legal title.
2. Most transactions have followed the pass-through mechanism.
3. In fact, many transactions have followed the escrow mechanism where receivables are transferred to an escrow account for payment to the buyer.
4. According to Duff & Phelps India, a rating agency, past deals have mostly been direct purchases of receivables by institutions and bigger NBFCs.

Features of Securitization cont..

5. Routing the transaction through a Special Purpose Vehicle is yet to gain popularity.
6. There appears to be no secondary market for securitized debt.
7. The market is unregulated and lacks transparency in terms of volume, price, parties to the transaction, etc.
8. The settlement procedures are not clear.
9. There are no standard accounting and valuation norms.

NON BANKING FINANCE COMPANIES (NBFCS)

What is NBFC?

- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of Loans , Advances, Acquisition of shares/stock/bonds/debentures/ securities issued by Government or local authority or other securities of like marketable nature, Leasing, Hire-purchase, Insurance business, Chit business.
- A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company (Residuary non-banking company).

HISTORICAL BACKGROUND

- The Reserve Bank of India Act, 1934 was amended on 1st December, 1964 by the Reserve Bank Amendment Act, 1963 to include provisions relating to non-banking institutions receiving deposits and financial institutions.
- With a view to review the existing framework and address these shortcomings, various committees were formed and reports were submitted by them.

THE COMMITTEES

- **James Raj Committee (1974)**
  - ✓ It was formed by the Reserve Bank of India in 1974.
  - ✓ Suggested for a ban on Prize chit and other schemes.
  - ✓ Based on these suggestions, the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 was enacted.
- **Dr. A.C. Shah Committee (1992)**
  - ✓ Agenda for reforms in the NBFC sector.
  - ✓ Wide ranging recommendations covering
    - ✓ compulsory registration of large sized NBFCs,
    - ✓ prescription of prudential norms for NBFCs
    - ✓ more statutory powers to Reserve Bank for better regulation of NBFCs.

- **Vasudev Committee (1998)**
  - ✓ RBI should consider measures for easing the flow of credit from banks to NBFCs
  - ✓ Consider prescribing a suitable ratio as between secured and unsecured deposits for NBFCs.
  - ✓ Appointment of depositors' grievance redressal authorities with specified territorial jurisdiction.
  - ✓ A separate instrumentality for regulation and supervision of NBFCs under the aegis of the RBI should be set up, so that there is a great focus in regulation and supervision of the NBFC sector.

NBFC's Versus Bank's

	BANKS	NBFCS
Definition	Banking is acceptance of deposits withdraw able by cheque or demand; NBFC cannot accept demand deposits	NBFC are companies carrying financial business
Scope of business	Scope of business of the bank is limited by sec 16(1) of BR Act.	There is no bar on NBFC carrying activity other then financial activity.
Major limitation on Business	No non banking activity are carried.	Cannot provide checking facilities.
Foreign investment	Up to 74% is allowed to private sector bank	Up to 100% is allowed
Need for a license	License norms are tightly controlled and generally it is perceived to be quite difficult to get a license for a bank	It is comparatively much easier to get a registration as an NBFC.
Regulations	BR Act and RBI Act lay down the stringent control over the bank.	Much lesser control over NBFC

REGULATIONS

- In terms of Section 45-IA of the RBI Act, 1934, it is mandatory that every NBFC should be registered with RBI to commence or carry on any business of non-banking financial institution. However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI.
- Should have a **minimum net owned fund** of Rs 25 lakh (raised to **Rs 200 lakh** wef April 21, 1999).
- NBFC have to maintain 10 and 15 per cent of their deposits in liquid assets effectively from January 1 and April 1,1998, respectively.
- All NBFCs are not entitled to accept public deposits. Only those NBFCs holding a valid Certificate of Registration with authorization to accept Public Deposits can accept/hold public deposits.

REGULATIONS

- They have to create reserve fund and transfer not less than 20 per cent of their net deposits to it every year.
- The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
- NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 11 per cent per annum.
- They have to obtain a minimum credit rating from anyone of the three credit rating agencies.
- NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.

Role of NBFCs

- Development of sectors like Transport & Infrastructure
- Substantial employment generation
- Help & increase wealth creation
- Broad base economic development
- Major thrust on semi-urban, rural areas & first time buyers / user.
- To finance economically weaker sections

IMPORTANCE OF NBFCs

- In the present economic environment it is very difficult to cater need of society by Banks alone so role of Non Banking Finance Companies and Micro Finance Companies become indispensable.
- The role of NBFCs as effective financial intermediaries has been well recognised as they have inherent ability to take quicker decisions, assume greater risks, and customise their services and charges more according to the needs of the clients.

- At present, NBFCs in India have become prominent in a wide range of activities like hire-purchase finance, equipment lease finance, loans, investments, etc.
- To help in developing the large number of industries as well as entrepreneur in different sectors of different areas.
- To cover all the areas which is being untouched or uncovered by RBI or other FCIs.

Types of NBFC

MUTUAL BENEFIT FINANCIAL COMPANY (MBFC)

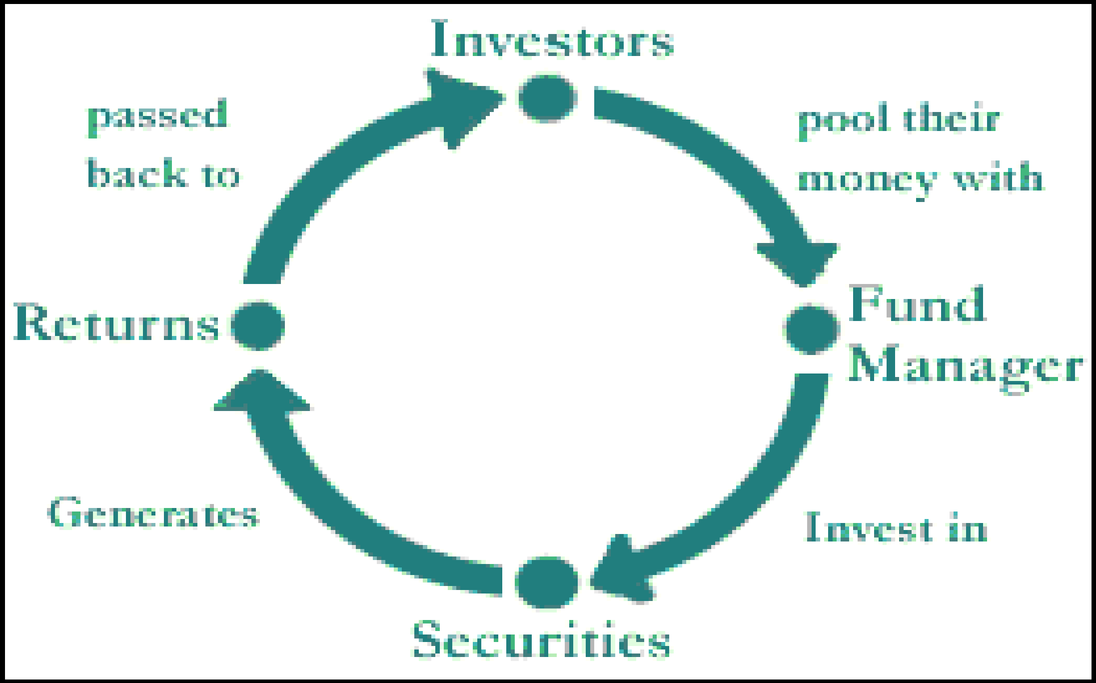
- Nidhis or Mutual Benefit Finance Companies are one of the oldest forms of non-financial companies. It is a company structure in which the company's owners are also its clients.
- That is, the mutual company's profits are distributed to its participating customers each year in proportion to their individual exposures to the company.
- Many insurance companies are structured as mutual companies.

- Some of the important objectives of Nidhis are to enable the members to save money, to invest their savings and to secure loans at favorable rates of interest.
- They work on the principles of complete mutuality of interest and are generally well-managed.
- The Government has granted certain concessions under Section 620A of the Companies Act, 1956.
- Primarily regulated by Department of Company Affairs (DCA) under the directions / guidelines issued by them under Section 637 A of the Companies Act, 1956.
- The Government of India constituted an Expert Committee in March 2000 (Chairman: Shri P.Sabanayagam)

INVESTMENT COMPANY

- Investment Company is any financial intermediary whose principal business is that of buying and selling of securities.
- It is a company whose main business is holding securities of other companies purely for investment purposes.
- The investment company invests money on behalf of its shareholders who in turn share in the profits and losses.
- Example : Mutual Fund Companies

CONCEPT OF MUTUAL FUNDS



- **BENEFITS OF MUTUAL FUNDS**
- *Diversification*
- *Relatively Less Expensive, Well Regulated*
- *Liquidity*
- *Transparency, Professional Expertise , Flexibility*

CLASSIFICATION OF MUTUAL FUNDS

- ***BY STRUCTURE:***

Open Ended

Closed Ended

- ***BY MANAGEMENT STYLE:***

Actively managed

passively managed

- ***BY INVESTMENT STYLE:***

Value investing

Growth investing

Blend investing

- ***BY CAPITALIZATION:***

Large cap funds

Mid cap funds

Small cap funds

EQUIPMENT LEASING COMPANY

Equipment leasing company is any financial institution whose principal business is that of leasing equipments or financing of such an activity.

Leasing

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments.

- The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent.

Advantages

- 100 % financing
- Flexibility
- Restrictive provisions absent
- Quick Finance
- Cost
- Risk management

Disadvantages

- A net lease may shift some or all of the maintenance costs onto the tenant.
- If circumstances dictate that a business must change its operations significantly, it may be expensive or otherwise difficult to terminate a lease before the end of the term.
- If the business is successful, lessors may demand higher rental payments when leases come up for renewal. If the value of the business is tied to the use of that particular property, the lessor has a significant advantage over the lessee in negotiations.
- **Example:** Shriram Transport Finance Corporation

HIRE-PURCHASE COMPANY

- Any financial intermediary whose principal business relates to hire purchase transactions or financing of such transactions.
- A method of buying goods through making installment payments over time.
- Under a hire purchase contract, the buyer is leasing the goods and does not obtain ownership until the full amount of the contract is paid.
- Hire purchase combines elements of both a loan and a lease. You reach an agreement with the dealer to pay an initial deposit, typically anything between 10% and 50%, and then pay off the balance in monthly installments over an agreed period of time. At the end of this period, the product is yours.

PROS & Cons

- The main advantage of a hire purchase agreement is that you can buy something you couldn't otherwise afford. Your monthly payments are effectively secured against your car – and this has both pros and cons. Positively, this means you're more likely to secure finance than you would be by shopping around for an unsecured loan as the lender has some 'security' in the form of your car – this is often reflected in better interest rates.

- On the downside however, you must be sure you can keep up with payments or the lender will have the right to repossess the vehicle.
- For most however, this is a safer form of finance than a regular secured loan – which puts your house at jeopardy if you can't meet repayments.
- Interest rates can be high.

LOAN COMPANY

- Loan company means any financial institution whose principal business is that of providing finance, whether by making loans or advances or otherwise for any activity other than its own (excluding any equipment leasing or hire-purchase finance activity).
- A loan is a type of debt. Like all debt instruments, a loan entails the redistribution of financial assets over time, between the lender and the borrower.
- **Types of loans:**
- **Secured :** A secured loan is a loan in which the borrower pledges some asset (e.g. a car or property) as collateral.

- **Unsecured :** Unsecured loans are monetary loans that are not secured against the borrower's assets.
- Credit card debt
- personal loans
- Bank overdrafts
- corporate bonds (may be secured or unsecured)
- **Demand:** Demand loans are short term loans that are typical in that they do not have fixed dates for repayment and carry a floating interest rate which varies according to the prime rate. They can be "called" for repayment by the lending institution at any time. Demand loans may be unsecured or secured.

MISCELLANEOUS NON-BANKING COMPANIES (MNBCS)

- MNBCs are mainly engaged in the Chit Fund business.
- Conducting or supervising as a promoter, by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall in turn, as determined by lot or by auction or by tender or in such manner as may be provided for in the arrangement, be entitled to the prize amount.

- A chit scheme generally has a predetermined value and duration. Each scheme admits a particular number of members (generally equal to the duration of the scheme), who contribute a certain sum of money every month (or everyday) to the ‘pot’. The ‘pot’ is then auctioned out every month. The highest bidder (also known as the prized subscriber)wins the ‘pot’ for that month. The bid amount is also called the ’discount’ and the prized subscriber wins the sum of money equal to the chit value less the discount. The discount money is then distributed among the rest of the members (or the non-prized subscribers)as ‘dividend’ and in the subsequent month, the required contribution is brought down by the amount of dividend.

- The Chit Fund companies have been exempted from all the core provisions of Chapter IIIB of the RBI Act including registration.

- In terms of Miscellaneous Non-Banking Companies (RB) Directions, the companies can accept deposits up to 25 per cent and 15 per cent from public and shareholders, respectively, for a period of 6 months to 36 months, but cannot accept deposits repayable on demand/notice.

RESIDUARY NON-BANKING COMPANIES (RNBCS)

- Company which receives deposits under any scheme or arrangement, by whatever name called, in one lump-sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any manner are called RNBCs.
- RNBCs are a class of NBFCs which cannot be classified as equipment leasing, hire purchase, loan, investment, nidhi or chit fund companies, but which tap public savings by operating various deposit schemes.
- The deposit acceptance activities of these companies are governed by the provisions of Residuary Non Banking Companies (Reserve Bank) Directions, 1987

- These directions include provisions relating to the minimum (not less than 12 months) and maximum period (not exceeding 84 months) of deposits, prohibition from forfeiture of any part of the deposit or interest payable thereon, disclosure requirements in the application forms and the advertisements soliciting deposits and periodical returns and information to be furnished to the Reserve Bank.
- Ten NBFCs are still functioning as RNBCs, the total deposits of which amounted to nearly Rs. 11,000 crore, constituting about 57.0 per cent of the total deposits of all reporting NBFCs.

HOUSING FINANCE

- The shelter sector of the Indian financial system remained utterly underdeveloped till 1980.
- The lack of adequate institutional supply of credit for house building was the main gap in the process of financial development in India.

- The Indian housing industry is highly fragmented, with the unorganized sector, comprising small builders and contractors, accounting for over 70% of the housing units constructed and the organized sector accounting for the rest.
- The organized sector comprises large builders and government or government affiliated entities.

- Banks now control 40% of this market and continue to show explosive growth.
- Finance for housing is provided in the form of mortgage loans.
- The suppliers of house mortgage loans in India are : HUDCO, SHFSs, central and state governments, HDFC, Commercial Banks, LIC (Jeevan Kutir & Jeevan Niwas) and NHB.

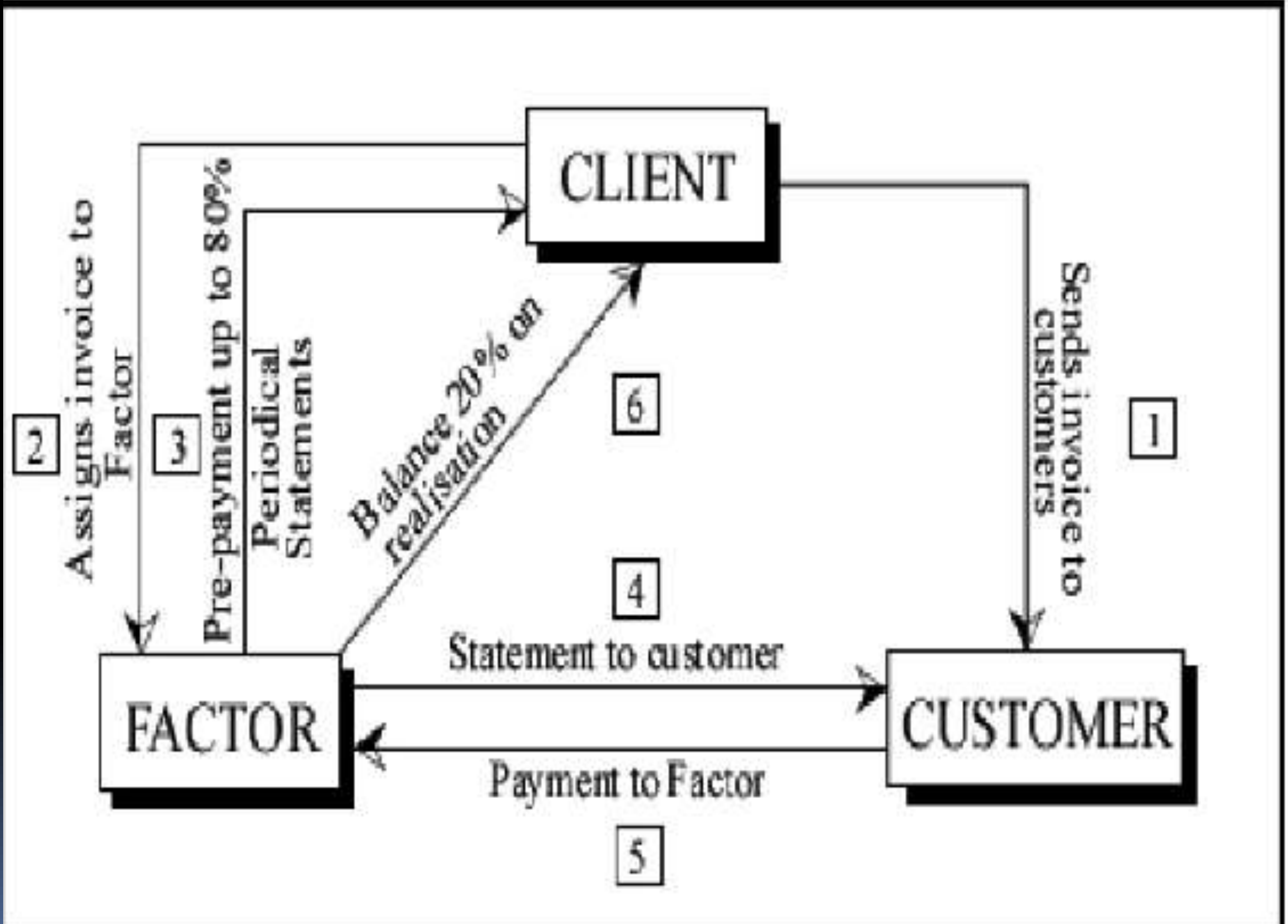
FACTORING

- **Factoring is defined** as 'a continuing legal relationship between a financial institution(the factor) and a business concern (the client), selling goods or providing services to trade customers (the customers) on open account basis whereby the Factor purchases the client's book debts (accounts receivables)either with or without recourse to the client and in relation thereto controls the credit extended to customers and administers the sales ledgers'.

- FACTOR : A factor is a financial institution which manages the debt collection on behalf of its clients and bears the credit risks associated with these.
- For servicing the receivables and bearing the risk, the factor charges a fee which is usually 1-3 % of the face value of the receivables. As to the payment to the client, the factor may do so as the amount is collected, or he make an advance payment. In the later, the factor will charge an interest in addition to a fee.

Factoring mechanism

- The parties involved in a factoring arrangement are:
- 1. The Client or the seller
- 2. The Debtor or the buyer
- 3. The Factor (International factoring may have a correspondent factor in addition to the domestic factor)


CLIENT
FACTOR
CUSTOMER
1
Sends invoice to customers
2
Assigns invoice to Factor
3
Pre-payment up to 80%
Periodical Statements
6
Balance 20% on realisation
4
Statement to customer
5
Payment to Factor

FINANCIAL SECTOR REFORMS

- NBFCs having foreign investment more than 75% and up to 100%, and with a minimum capitalisation of US$ 50 million, can set up subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital :RBI

- **NBFC-MFI norms modified:** . In order to provide encouragement to NBFCs operating in the north-eastern region, the minimum NOF is to be maintained at Rs.1 crores by March 31, 2012, and at Rs.2 crores by March 31, 2014.

- **Operational flexibility :** To allow operational flexibility, the RBI has asked the NBFCs to ensure that the average interest rate on loans during a financial year does not exceed the average borrowing cost during that financial year plus the margin, within the prescribed cap.

Overview of Present Position

- NBFCs are highly heterogeneous, continue to offer wide range of niche and tailor-made financial services.
- In terms of relative importance of various activities financed by them, hire purchase finance is the largest activity, accounting for greater than 1/3rd of total assets, followed by loans and equipment leasing.
- The number of NBFCs have declined after 2000 due to mergers, closures, cancellation of licenses, regulatory strictness.

- The maximum rate of interest that NBFCs can pay on their deposits has been reduced from 12.5 % to 11% per annum w.e.f March 4, 2003.
- The NPAs of NBFCs has not shown a clear decline over the years.
- There has been a decline in the shares of deposits in their total sources of funds which has made them rely more on market borrowings which has ultimately caused increase in their cost of funds.
- RBI has decided to impose penalties on NBFCs having deposits of Rs. 50 crores & above if they don’t submit periodic returns to RBI.

CONCLUSION

- The NBFCs have not been very much profitable.
- The operating cost of NBFCs has increased and it stands much higher than co-operative banks. This is one area in which improvement is needed.
- **Enhancing the credit delivery mechanisms**: The credit delivery mechanism needs to be more transparent and hassle free. There should be more stringent norms for the defaulters.

- **Strengthening the professionalism of NBFC sector through education and training**, making them more organised, RBI needs to educate people about NBFC, to reduce interest cost and hence benefit the ultimate consumer.


Thank you!


WELCOME

STRUCTURE OF INDIAN BANKING SYSTEM

INTRODUCTION

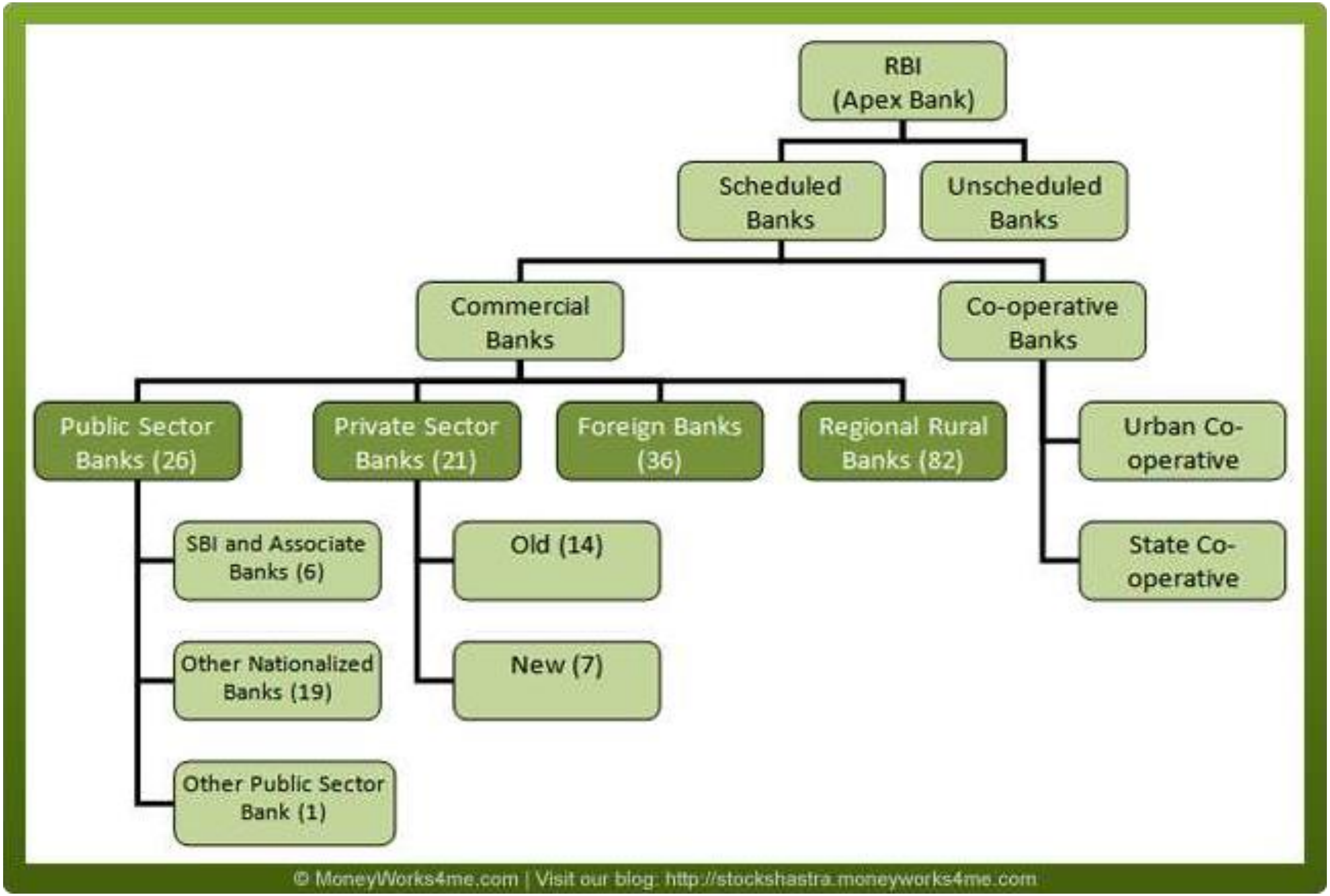
Banking in India in the modern sense originated in the last decades of the 18th century. The first banks were Bank of Hindustan (1770-1829) and The General Bank of India, established 1786 and since defunct.

The largest bank, and the oldest still in existence, is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955. For many years the presidency banks acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935.

In 1969 the Indian government nationalized all the major banks that it did not already own and these have remained under government ownership. They are run under a structure know as 'profit-making public sector undertaking' (PSU) and are allowed to compete and operate as commercial banks. The Indian banking sector is made up of four types of banks, as well as the PSUs and the state banks, they have been joined since the 1990s by new private commercial banks and a number of foreign banks.

Banking in India was generally fairly mature in terms of supply, product range and reach-even though reach in rural India and to the poor still remains a challenge. The government has developed initiatives to address this through the State Bank of India expanding its branch network and through the National Bank for Agriculture and Rural Development with things like microfinance.

INDIAN BANKING SYSTEM AT A GLANCE



RESERVE BANK OF INDIA

- Established in 1935
- Apex body of Indian banking system
- Headquarters is in Mumbai
- India's monetary authority
- Supervisor of financial system
- Issuer of currency
- Banker to bank
- Banker to government
- Maintains financial stability

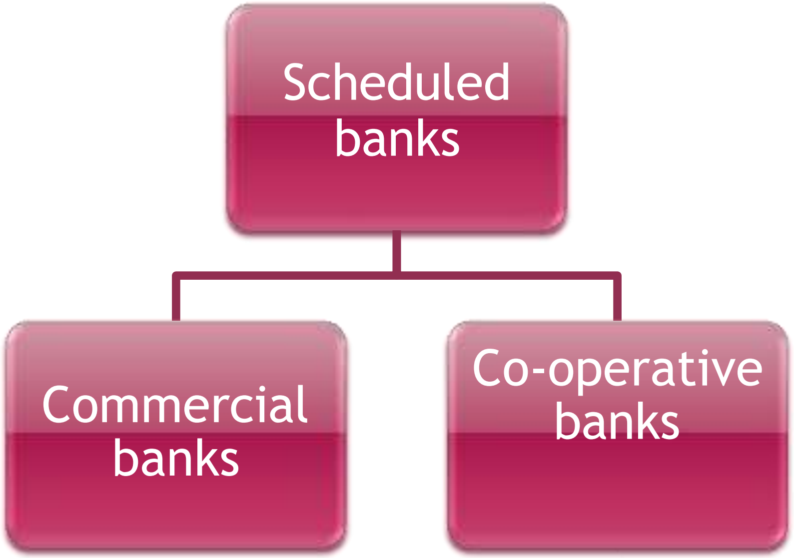
SCHEDULED BANKS

Scheduled banks are those banks whose name appears in the 2nd schedule of Reserve Bank Of India Act, 1934.

NON-SCHEDULED BANKS

Non-scheduled banks are those banks whose name doesn't appear in the 2nd schedule of Reserve Bank Of India Act, 1934.

BANKS UNDER SCHEDULED BANKS



COMMERCIAL BANKS

They are the banks mainly deal with commercial banking operations like acceptance of deposits and granting loans to the public. They are mainly classified into four:-

1. PUBLIC SECTOR BANKS

Public sector banks are those banks which are owned and controlled by the government . All the nationalized banks and regional rural banks are public sector banks.

Examples:

- State Bank of India and it's 7 Subsidiaries.
- Bank Of Baroda
- Syndicate Bank
- Vijaya Bank
- Canara Bank etc.

2. PRIVATE SECTOR BANKS

These banks are owned and controlled by private institutions or individuals and not by the government.

Examples:

- South Indian Bank
- ICICI
- HDFC
- Axis bank etc.

3. FOREIGN BANKS

These banks are formed and registered in foreign countries and have their head office in foreign country.as far as India is concerned, any bank registered outside India and have a branch in India is a foreign bank.

Examples

- Yes Bank
- Citi Bank
- HSBC
- Deutsche Bank etc.

4. REGIONAL RURAL BANKS

Regional Rural Banks (RRBs) were established by Regional Rural Banks Act, 1976 with a view to satisfy the banking facilities and credit needs of the rural people.

Examples;

- Andhra Pradesh Grameena Vikas Bank,
- Chaitanya Godavari Grameena Bank,
- Kerala Grameen Bank etc.

B) CO-OPERATIVE BANKS

These are banks where co-operative societies that are formed at a state or district level have a share of more than 51%. these are primarily set-up for the purpose of services the farming community or to aid in land or infrastructure development at the state or district level. They are of two:-

1. <u>URBAN CO-OPERATIVE BANKS</u>

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centred around communities, localities work place groups. They essentially lent to small borrowers and businesses

examples:-

- Maharashtra state apex co-operative bank
- Karnataka state apex co-operative bank

2. STATE CO-OPERATIVE BANKS

State co-operative banks are the apex co-operative institution in a state . They are federations of district co-operative banks, and they monitor the activities of all co-operative banks in the state.

Examples:-

- Kerala state co-operative bank
- Orissa state co-operative bank x
- West Bengal state co-operative bank

3. <u>National bank for agriculture and rural development (NABARD)</u>

National bank for agriculture and rural development (NABARD) was established as an apex bank that provides finance for agriculture and rural development.

NABARD

NATIONAL BANK FOR AGRICULTURE
AND RURAL DEVELOPMENT


many
Thanks!

CIBIL, Fair practices code for debt collection & banking codes & standards board of India

Credit Information Bureau (India) Ltd.

- Ownership Structure: CIBIL, India's first credit information bureau was established by SBI and HDFC, with a shareholding of 40% each, while Dun & Bradstreet Information Services India Private Ltd (D&B) and Trans Union International Inc. (TU) hold 10% each.
- CIBIL is a repository of information, which contains the credit history of commercial and consumer borrowers.
- CIBIL provides this info. To its members in the form of credit information reports (CIRs)

- RBI in its ‘Annual Monetary and Credit Policy’ for the year 2004-05, had stated that in respect of credit bureaus, ‘it is desirable that the objective should be to move towards a sufficiently diversified ownership with no single entity owning more than 10% of the paid up capital in the first stage and 5% later’.
- As on 31 Dec. 2006, HDFC, SBI,ICICI Bank, D&B and TU (Trance Union), hold 10% stake each in CIBIL., whereas Citicorp Finance (India) Ltd., Standard Chartered bank, HSBC, Punjab National Bank, Bank of India, Central Bank of India, Union Bank of India, Bank of Baroda and Indian Overseas bank hold 5% stake each, while the remaining 5% is equally held by GE Strategic Investments Ltd. and Sundaram Finance.

Functions of CIBIL

- It is a composite credit bureau, which caters to both commercial and consumer segments. The Consumer Credit Bureau covers credit availed by individuals while the Commercial Credit Bureau covers credit availed by non-individuals such as partnership firms, proprietary concerns, private and public limited Co. etc.
- The aim of CIBIL’s Commercial Credit Bureau is to minimise instances of concurrent and social defaultsby providing credit information, pertaining to non-individual borrowers such as public ltd. companies, private ltd. co. , partnership firms, proprietorships, etc.
- It maintains a central database of info. As received from its members.

- It collects and sisseminates this info.on demand to members in the form of commercial Credit Information Reports (CIR) to assist them in their loan appraisal process.

Fair Practices Code for Debt Collection

- Demand for Lenders' Liability Law:
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was enacted in India in 2002.
- The Act allowed banks to take possession of assets of defaulting companies without going through the cumbersome legal process.
- On the basis of the recommendations of the working group on Lenders' Liability Laws constituted by the Govt. of India., RBI, in consultation with the Govt and some banks and financial institutions, finalised a set of codes called 'the Fair Practices Code for Lenders' and adised banks to adopt the guidelines.

- All the banks in India have framed their own set of Fair Practices Codes as per the guideline and implemented it from Nov. 1, 2003
- General Guidelines: Applications for Loans and their Processing
- A) Loan application forms in respect of priority sector and advances of up to Rs. 2 lakh should be comprehensive. It should include info. About the fees/charges,if any payable for processing. The amt. of such fees is refundable in the case of non-acceptance of application.

- B) banks and fin. Intuitions shall give acknowledgement for receipt of all loan applications. The time frame, within which loan applications up to Rs. 2 lakh will be disposed should also be indicated in acknowledgement of such applications.
- C) Banks should scrutinise the loan applications within a reasonable period of time. If additional details/documents are required, they should intimate the borrowers immediately.
- D) If small borrowers seeking loans up to 2 lakh, the lenders should convey in writing, the main reason which, in the opinion of the bank after due consideration, have led to rejection of the loan applications within the stipulated time.

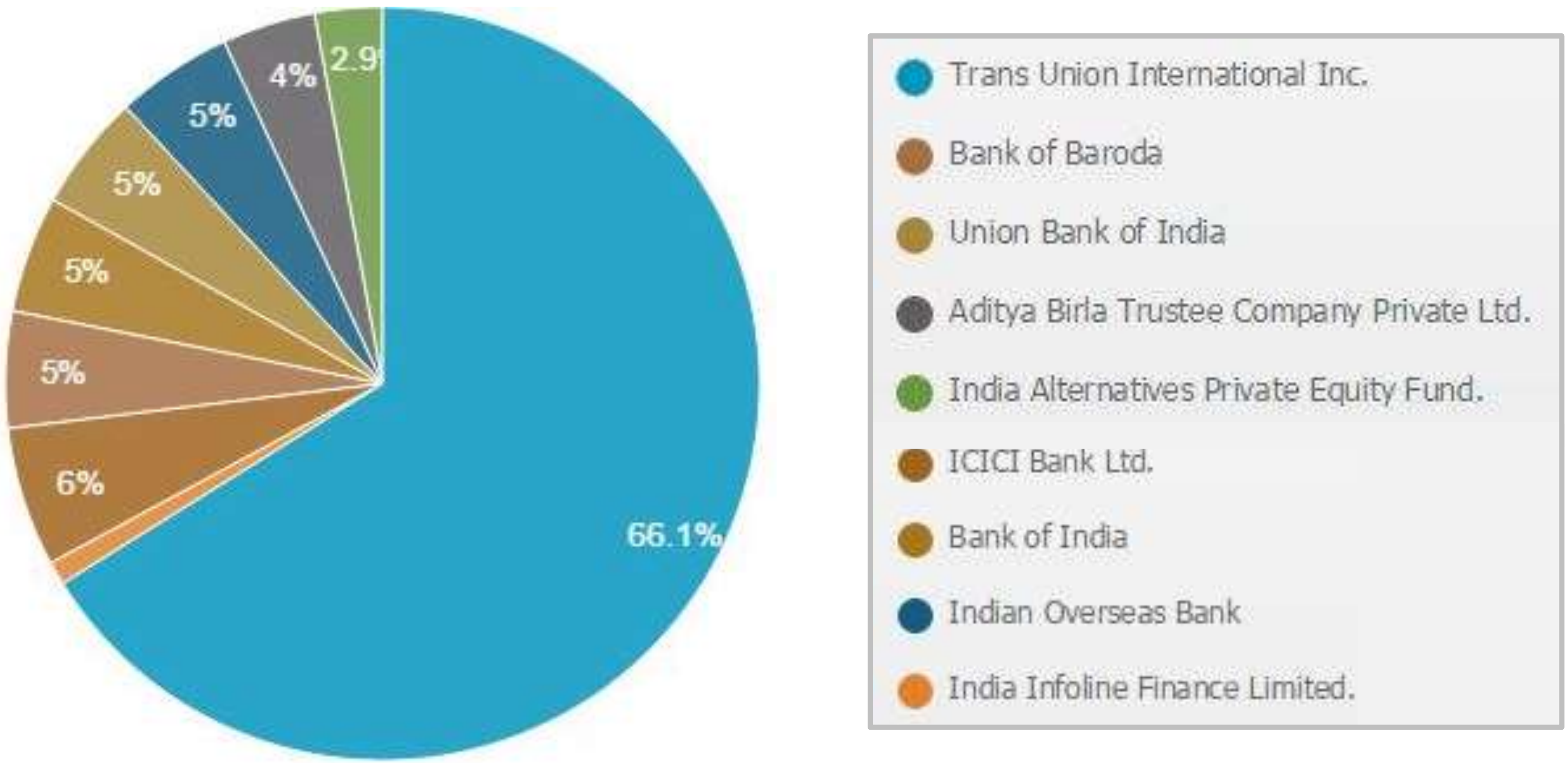
- **<u>Loan Appraisal and Terms/Conditions:</u>**
- A) lenders should ensure that credit proposal Is properly appraised after assessing the creditworthiness of the applicants they should not use margin and security stipulation a a substitute for due diligence on credit-worthiness.
- B) Terms and conditions and other caveats governing credit facilities are arrived at after due negotiation with the borrower should be reduced in writing and duly certified by the authorised official. A copy of the loa agreement along with a copy each of all enclosures quoted I the loan agreement should be furnished to the borrower.

- Contd.
- C) The lender should convey to the borrower the sanction of credit limit along with the terms and conditions thereof and keep the borrower’s acceptance of these terms and conditions on record.
- D) as far as possible, the loan agreement should clearly stipulate that the credit facilities granted are solely at the discretion of the lenders. These may include approval or disallowing facilities, such as drawings beyond the sanctioned limits, honoring cheques issued for a purpose other than the one specifically agreed to in the credit sanction and disallowing drawing on a borrowal account on its classificationa s a non-performing asset

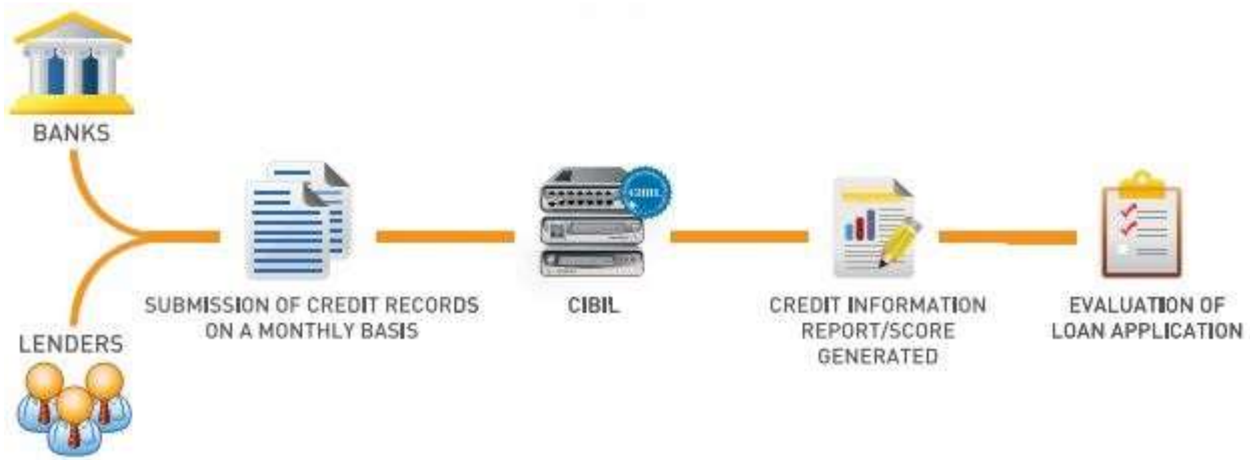
Credit Information Bureau (India) Limited

- Founded in August 2000
- Headquarter in Mumbai, Maharashtra, India
- Mr Satish Pillai, Managing Director
- Mr M. V. Nair, Chairman
- **900 strong member base including all leading public & private sector banks, financial institutions, NBFCs and housing finance companies**

Shareholding Pattern



What does CIBIL do?



- Collects and maintains records of an individual's payments pertaining to loans and credit cards
- Records are submitted by banks and other lenders, on a monthly basis
- Credit Information Reports (CIR) is created
- Credit scores are provided to lenders to help evaluate and approve loan applications.

Role in the Loan Approval Process

- **Credit Score** helps loan providers quickly determine, who they would like to evaluate further to provide credit.

  300 ≤ CIBIL TransUnion Score ≤ 900

  Loan providers prefer credit scores ≥ 750.

- **Analysis of the CIR** to determine the eligibility i.e. the applicant's ability to take additional debt and repay additional outflows given their current commitments.
- The loan provider will request for the applicant's income proof and other relevant **documents** in order to finally **sanction the loan**.

CIBIL for us as an individual

- CIBIL score was made available to the individuals since April 2011.
- **Faster loan approvals**
- **Empowers individuals** to see world financial and credit history more clearly and take better decisions

Example: How good credit history helps in getting lower rates for loans?

Mr. Roy wanted a car worth Rs.10 lakhs and already had Rs.4 lakhs.

Auto loan of **Rs.6 lakhs**

Bank A:

11.25% for a tenure of **5 years**

EMI = **Rs.12,999**

Bank B:

10.75% for a tenure of **5 years**

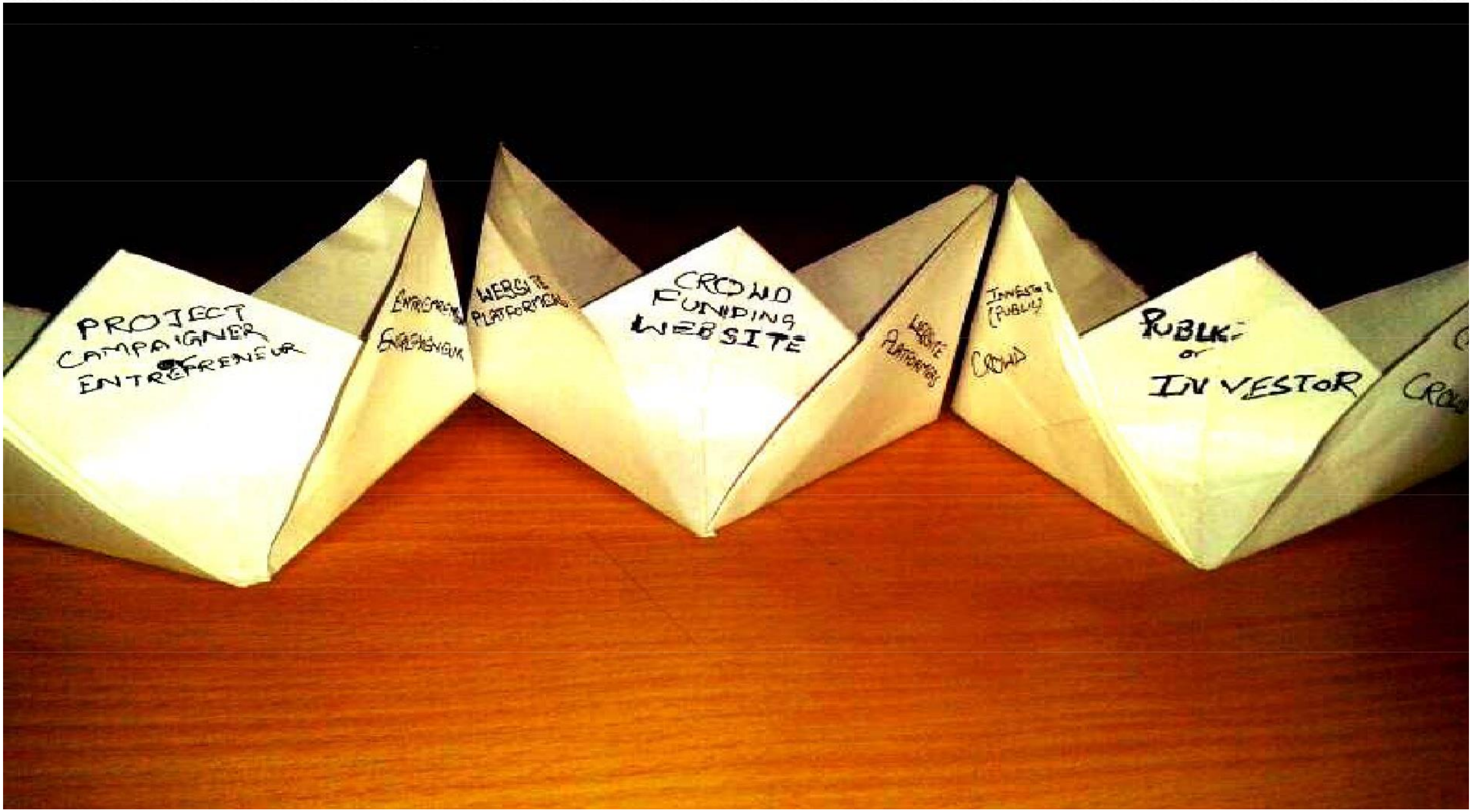
EMI = **Rs.12,856**

He called **Bank A** to decline their offer since **Bank B** had given him a better quote. After checking his CIR, **Bank A** **matched the offer by giving him a rate of 9.85%; where the EMI decreased to** **Rs.12,601**, resulting in a total saving of **Rs.23,880** over the period of **5 years**.

Hence, good credit history and credit score earned him a **3% discount** on the loan.


Thank you...

Crowd Funding : Reference to India



Crowd Funding : What is it?

- Crowd Funding is an internet-inspired means of raising money from the mass market, for a project or business.
- "A continuous and growing series of virtual on-line auction houses, matching borrowers and lenders; investors and investees; and donors and donees".

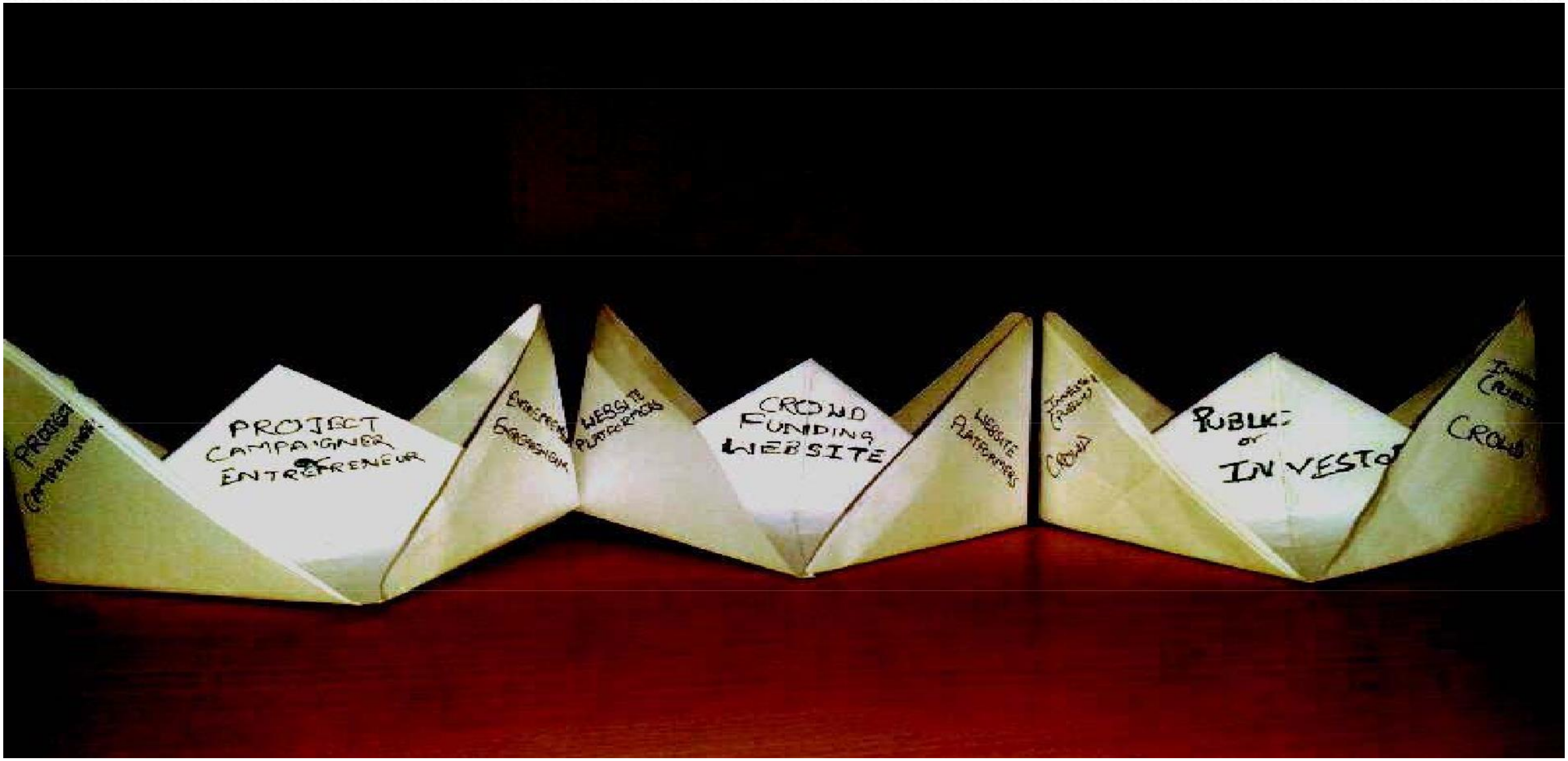
Crowdfunding :History

- Crowdfunding has its origins in the concept of crowdsourcing, which is the broader concept of an individual reaching a goal by receiving and leveraging small contributions from many parties. Crowdfunding is the application of this concept.

- Hence, Crowd funding, a popular concept started in the US and the UK, is an emerging way of raising capital, through the use of internet or social networking sites such as Facebook or LinkedIn or Twitter or even some dedicated websites.

Crowdfunding : Parties

Three parties are involved namely **Project Campaigner or Entrepreneur**, **Website Platformer**, and **Crowd or Investor** as to constitute the business of crowdfunding. Whereas the role of Website Platformer is to bring the other Parties jointly and meet together.



How to Crowdfund Your Project..

Many projects fail because their product prototype isn't impressive to attract crowd. Here are a few points that One (Borrower; Investees; Donees) should consider before launching One's crowdfunding drive:

- **Choose a platform or to create an online profile**
- **Get your content ready and explain your project**
- **Create Interest for fund raising goals**
- **Get payments right**

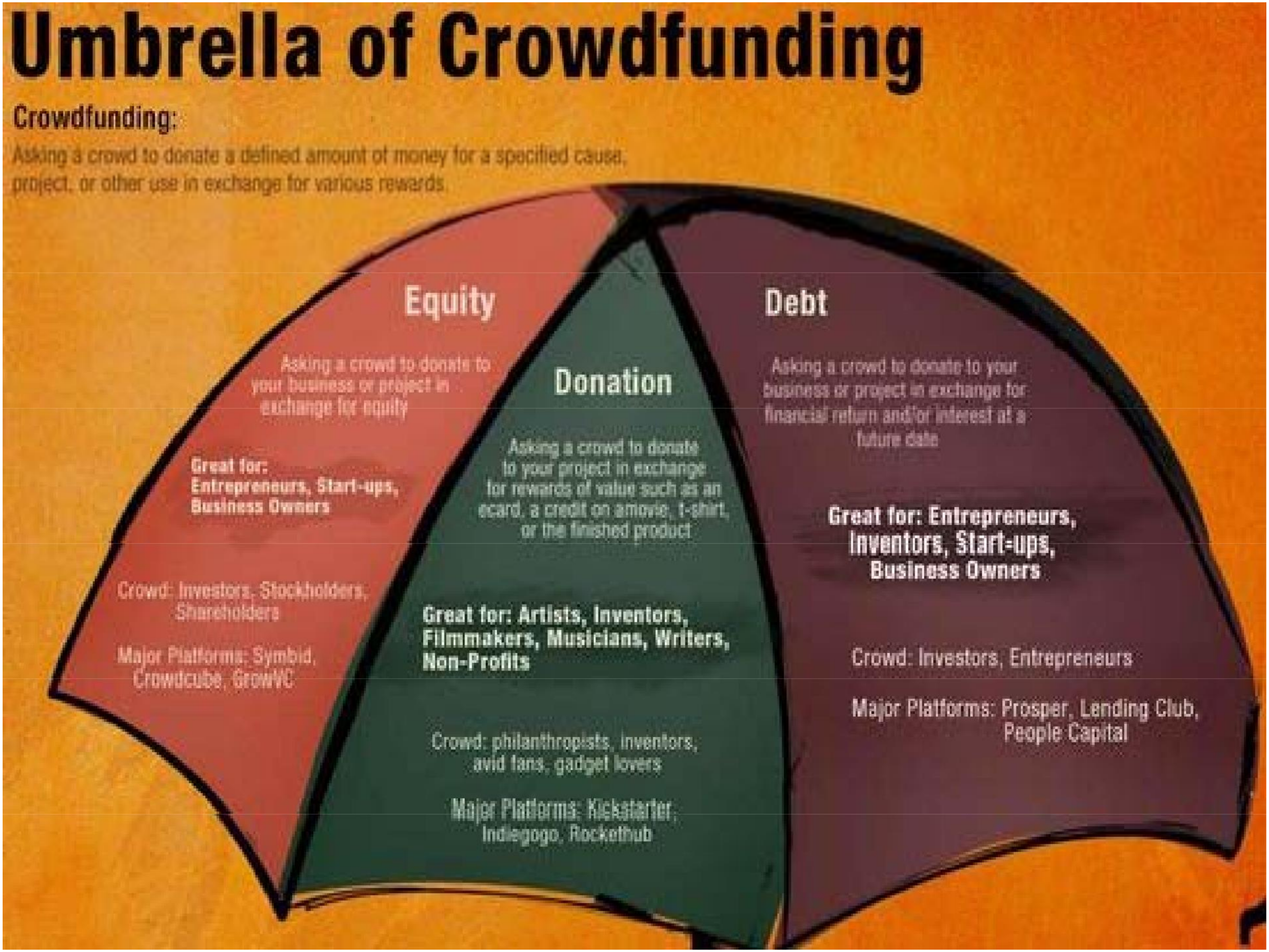
  Share the same with public at large, including your peers, relatives, friends of friends, and so forth.

List of Crowdfunding Websites : India

- **Ignite Intent**
- **PikAVenture**.com
- **start51.com**
- **YourSeva**
- **RangDe**
- **WeFunder**
- **Ketto**
- **LetsVenture**
- **WishBerry**
- **Catapooolt**

Crowdfunding : Models

- **1. Donation and reward based:** The platform accepts a donation from many donors for projects. In most cases, the return involves finished goods like the "pebble watch" or a signed DVD of the movie received by the crowd. Sites like Ketto do this kind of crowdsourcing in India.
- **2. Lending based:** These borrowers take money with a promise to return it with certain interests from different people (lenders) and facilitate loans or microfinance to the needy. Microfinance platform Milaap is an example of such crowd sourcing in India.
- **3. Equity based crowdfunding:** This mode of crowdfunding, where investors take a share of equity in the project or startup, is not legal in India yet.


Umbrella of Crowdfunding
Crowdfunding:
Asking a crowd to donate a defined amount of money for a specified cause, project, or other use in exchange for various rewards.
Equity
Asking a crowd to donate to your business or project in exchange for equity
Great for: Entrepreneurs, Start-ups, Business Owners
Crowd: Investors, Stockholders, Shareholders
Major Platforms: Symbid, Crowdcube, GrowVC
Donation
Asking a crowd to donate to your project in exchange for rewards of value such as an ecard, a credit on amovie, t-shirt, or the finished product
Great for: Artists, Inventors, Filmmakers, Musicians, Writers, Non-Profits
Crowd: philanthropists, inventors, avid fans, gadget lovers
Major Platforms: Kickstarter, Indiegogo, Rockethub
Debt
Asking a crowd to donate to your business or project in exchange for financial return and/or interest at a future date
Great for: Entrepreneurs, Inventors, Start-ups, Business Owners
Crowd: Investors, Entrepreneurs
Major Platforms: Prosper, Lending Club, People Capital

CrowdFunding Scenario : India

Interestingly, it can be said that India has seen a massive crowdfunding success story many years before the term was coined: the story of the Reliance Industries founder Dhirubhai Ambani. His small yet growing textile business was crowdfunded by communities across the Indian state of Gujarat.

- Recently, platforms such as Wishberry and Ignite Intent have been launched in the country.
- There have been attempts at crowdfunding for events like the Goa Project and campaigns like Teach for India.
- Crowdfunding is slowly becoming an alternative funding channel for the film industry.

Crowdfunding: Drivers In India

- Why is there hope for crowdfunding in India? Varun Seth, the Founder & CEO of Ketto, a crowdfunding platform based in Mumbai, feels that India is being the biggest countries for Non Government Organisations (NGOs), so crowdfunding stands a big chance.
- Section 135 of the new Companies Act,2013 which mandates all companies to spend 2% of their average net profits on corporate social responsibility, will also help them crowdfunding gain attraction.

Crowdfunding fraud: How big is the threat..

- The $1.5 million worth of reported scams are less than 1 per cent of the total money raised by Kickstarter for projects in last five years. (source : Economic Times)

- Crowdfunding scam: Someone copied Ken Lowery and Robert Wilson IV's Kickstarter campaign for Like a Virus, including the video, and made it into an IndieGoGo campaign, presumably planning to pocket the money and run.

Indian view:

"Product-based projects are in huge demand but they are also the most risky as such projects have high chances of being fake,”. Due diligence is required before accepting such Projects said Rajat Das, founder of Delhi based crowdfunding platform thehotstart.com.

- "If you compare the scam rate in crowdfunding , it is much lower than even IPOs," said Ahmedabad based Ateet Bajaj, who founded crowdfunding platform start51.com .

NB: **Recent study commissioned by the World Bank** that addressed the issue of crowdfunding fraud in detail did not cite one case. (Source : www.infodev.org)

KeyPoints Involved In CrowdFunding : India

- **The crowd can not get any shares or profits from the success of the company in case of donation based model and lending based model**
- **Offering incentives may be seen as offering return on investment in case of donation based model**
- **Who ensures that promises are kept?**
- **Auditing and accounting of the funds raised**
- **Role and liability of the funding platforms**

Challenges in India

- Low trust levels of doing the things online is also a challenge.
- As long as the crowdfunding platforms on behalf of project campaigners or entrepreneurs are not making any financial promises to the contributors, they should not be safe to operate especially in case of Lending based model and Equity based model.
- The crowdfunding industry is not so investor-friendly.
- People are not ready for this concept as it is new one and online based, channelized through Internet.

As Regulations in India

- Here in India, the concept is catching up fast and is posing a danger at the same time as many money laundering schemes might run in the name of crowdfunding via social media, pushing SEBI to set up a regulatory framework if it is found that such platforms involve large amounts of money or issuance of securities.
- A discussion is on to find a nodal agency for such activities following a talk with various stakeholders like banking regulator RBI, Finance Ministry and Corporate Affairs Ministry.
- An official from SEBI stated that crowdfunding can be either regulated under SEBI's existing norms for Collective Investment Schemes or Alternative Investment Funds.
- But still there is no proper legal regime as to regulating the crowdfunding in India.

Had a look on these Datas….

Lets take a look at some data:-

- Total number of projects crowdfunded so far: More than 150!
- Total amount raised through crowd-funding in India: More than INR 300 Lakhs!
- Highest amount crowdfunded for a single project: INR 84 Lakhs (Onir's film I AM)
- Highest number of contributors for a single project: 610 (Pawan Kumar's film LUCIA)
- Crowdfunding Platforms: More than 3

NB: (Data Source Analysis of existing platforms and key crowdfunded projects done by team at Catapooolt)

Some key demographics of Crowdfunders in India

- Average contribution per project: Rs 2,800/-
- Average number of contributors per project: 24
- Most contributors are from cities Mumbai and Delhi. Almost 60% of current funders are coming from non-metros and international destinations.
- Most crowdfunders are currently males aged between 25-40 years

NB: (Data Source Analysis of existing platforms and key crowdfunded projects done by team at Catapooolt)

A Big Example set-up “Lucia” & “I AM” films for fim industry in relation to crowd funding: India

- Lucia, an independent Kannada film made by an ex-IT professional, Pawan Kumar . It made on the total budget of Rs 71 lakhs and has been already sold to Udaya TV for about Rs 95 lakhs. The film has almost 600 producers approached through his crowdfunded campaigning link. Lucia is being the first ever crowdfunded regional film which managed to raise Rs 51 lakhs in a span of just 31 days!
- This film is thus yet another ratification of crowdfunding, which is a $6 Billion global phenomenon today. It is gradually firming up its presence and success in India.

- According to Onir, the Director of film “I Am” (which been financed through donations by more than 400 persons approached through Wishberry Site), said that the idea of crowd funding is not legal as per the Indian taxation system. He recalls how he received a letter from the tax department stating that he couldn't raise funds for his film from the public.
- But Priyanka Agarwal, CEO of a crowd-funding website said: "Onir raised funds for film from locals and foreign contributors in exchange for profit. Thus If he wasn't offering 'profits', then he wouldn't have faced any issue."

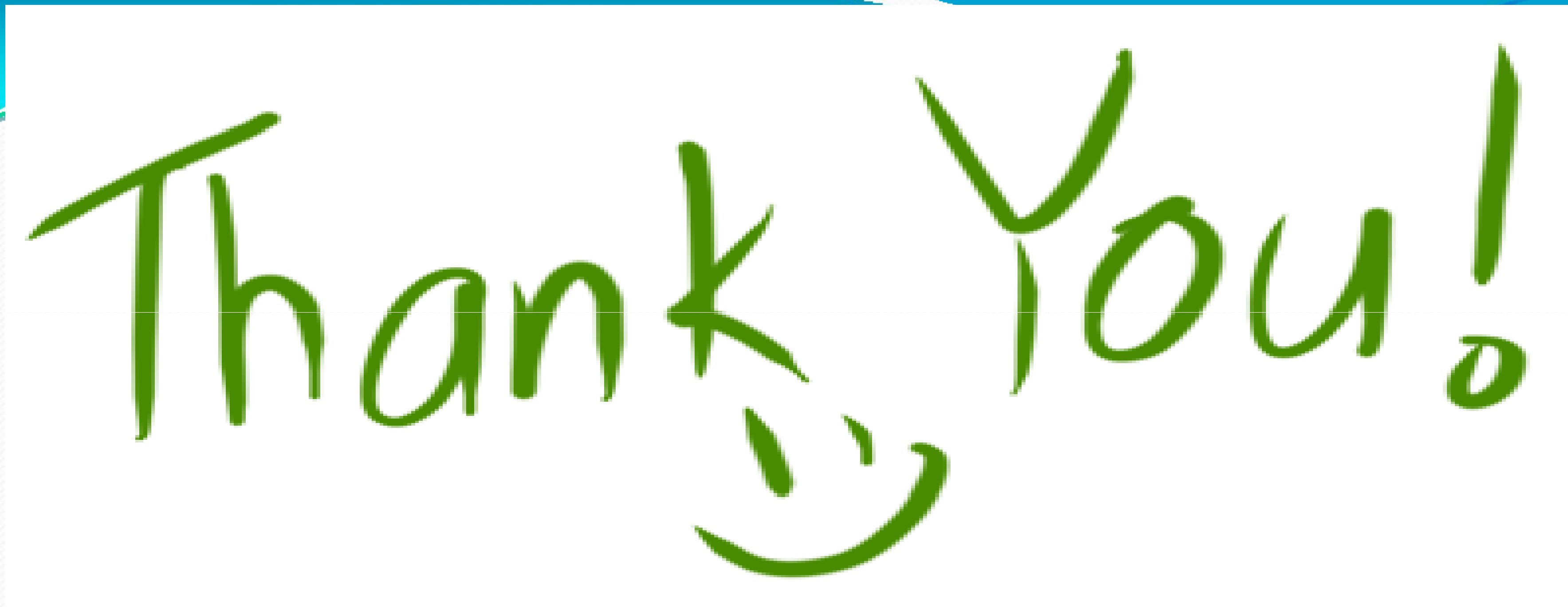
Conclusion

- There is no doubt that crowd funding is rapidly being looked as a serious way of raising funds for startups and new businesses in India.
- However, there are serious concerns which one needs to ponder upon as :

1. While on one hand, it perhaps bit derogatory to seek community help for their project; on the other, most of them still don’t know what a crowd-funding campaign entails and wrongly perceive it to be some type of magic potion which can give instant results.

2. India, the prominent categories are still largely restricted to either NGO causes or entertainment projects. Why aren't these platforms looking at encouraging other categories onto this domain?

Thus, to conclude by saying that one not only needs to focus on the grey legal areas but on the other said aspects so that crowd funding platforms should be more trustable, transparent and democratic in nature with the fund raisers and project campaigners.


Thank You!

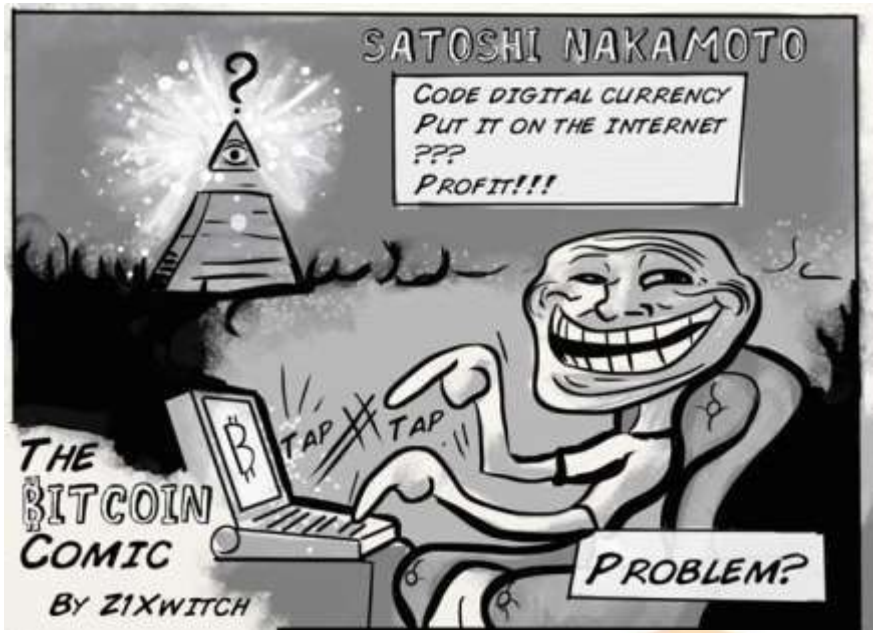

obrigado
Dank U
Merci
mahalo
Köszi
спасибо
Grazie
Thank you
mauruuru
Takk
Gracias
Dziękuję
Děkuju
danke
Kiitos

CRYPTOCURRENCY

Contents

What is Cryptocurrency?

A cryptocurrency (or crypto currency) is a digital asset designed to work as a medium of exchange using cryptography to secure the transactions and to control the creation of additional units of the currency.



Conventional vs Digital Currency

	Fiat or conventional currency	Cryptocurrency
Type	Real	Virtual
Intermediates	Yes	No (Peer-to-Peer)
Portability	Yes (except heavy cash)	Highly portable
Durable	Moderate	Highly durable
Acceptance	National	Global (throughout the internet)

Conventional vs Digital Currency

	Fiat or conventional currency	Cryptocurrency
Secure *(cannot be counterfeited)*	Moderate	High
Scarce *(Predictable Supply)*	Low	High
Sovereign *(Government Issued)*	Yes	No
Decentralized	No (Central bank control)	Yes (controlled by complex math)
Smart *(Programmable)*	No	Yes

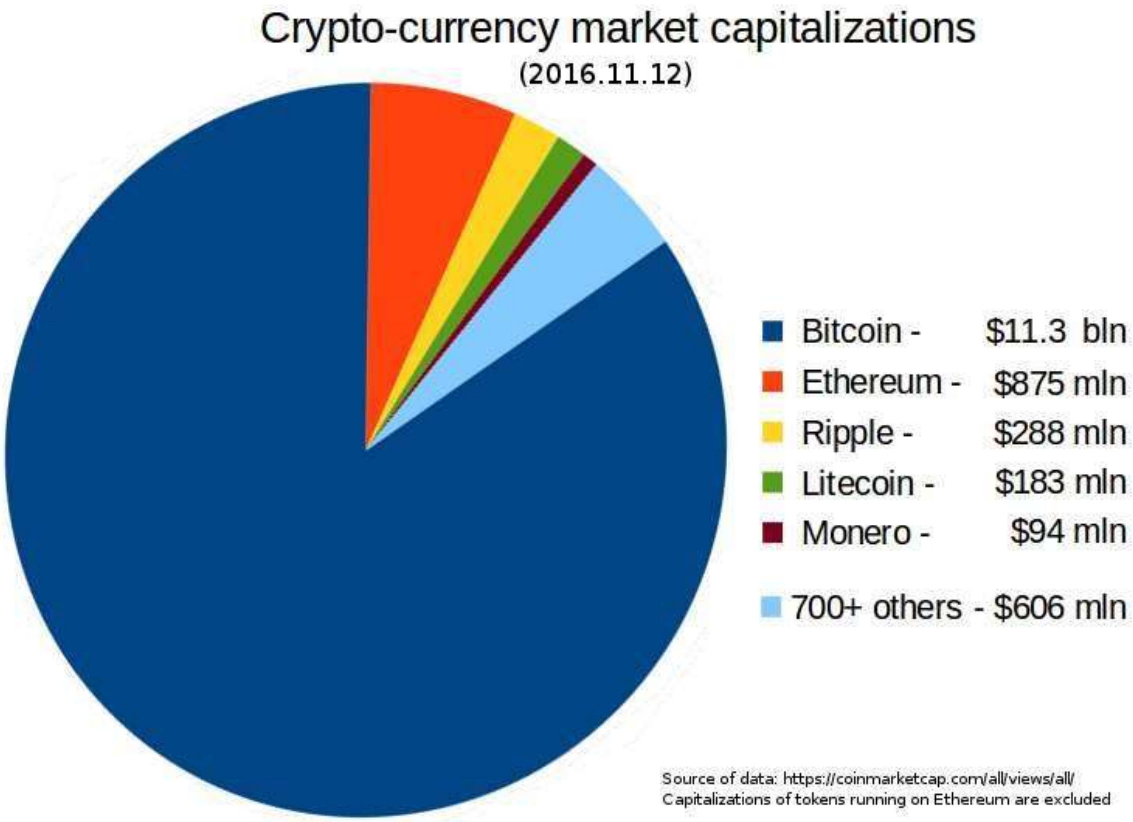
Why use Cryptocurrency?

- Fast, Safe and cheap
- Ease of use and highly portable
- Untraceable (pseudo-anonymous transactions)
- Transparent and neutral
- Decentralized nature
- Active involvement of users
- Fewer risks for merchants
- Freedom to transact
- Low inflation and collapse risk

Risks

- **Hackers.** Cryptocurrencies are targets for highly sophisticated hackers, who have been able to breach advanced security systems.
- **Fewer protections.** If you trust someone else to hold your cryptocurrencies and something goes wrong, that company may not offer you the kind of help you expect from a bank or debit or credit card provider.
- **Cost.** Cryptocurrencies can cost consumers much more to use than credit cards or even regular cash, often due to price volatility.
- **Scams.** Fraudsters are taking advantage of the hype surrounding virtual currencies to cheat people with fake opportunities.
- **Lack of Transparency.** The anonymous nature of cryptocurrencies make transparency and accountability difficult for consumers seeking to ensure the safety of their investments.

Types of Cryptocurrency



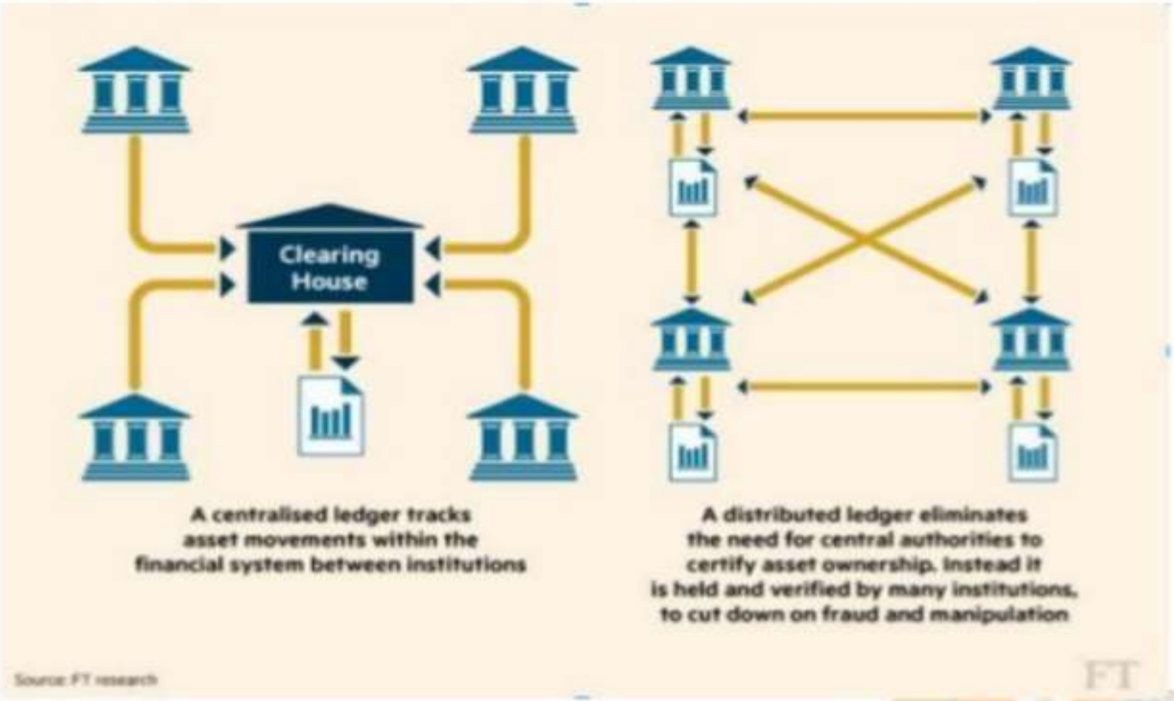
Example : Bitcoin

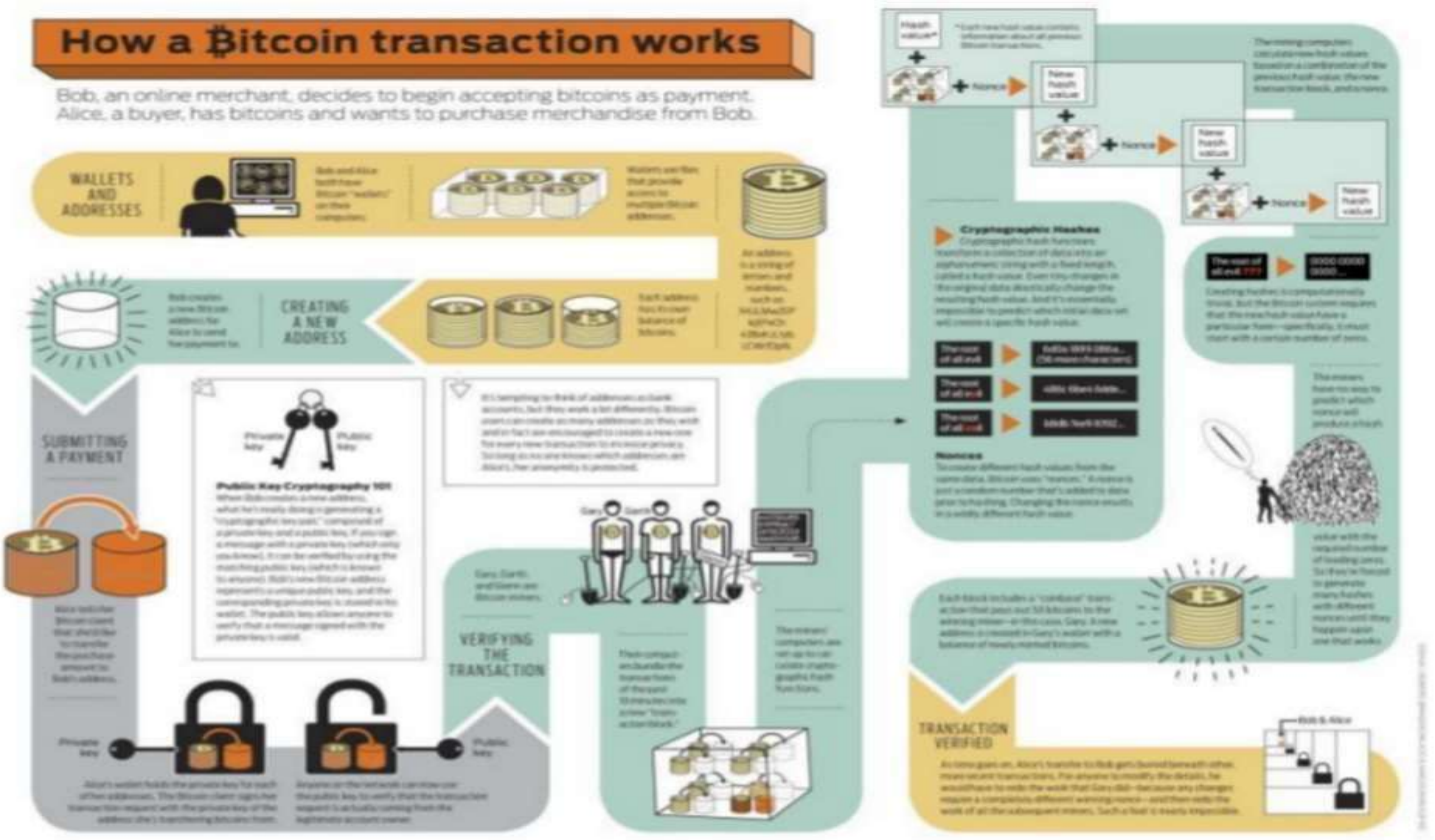
- Both a cryptocurrency and an electronic payment system
- Satoshi Nakamoto in 2008
- First decentralised payment network
- System is peer-to-peer
- 21 million bitcoins
- Completely Open source
- 1BTC = $1258.48

Example : Bitcoin

Bitcoin Technology

- Distributed ledger technology
- Mining
- Mining hardware
- Mining Software
- Blockchain
- Bitcoin wallets




How a Bitcoin transaction works
Bob, an online merchant, decides to begin accepting bitcoins as payment.
Alice, a buyer, has bitcoins and wants to purchase merchandise from Bob.
WALLETS AND ADDRESSES
CREATING A NEW ADDRESS
SUBMITTING A PAYMENT
Private key
Public key
Public Key Cryptography 101
VERIFYING THE TRANSACTION
Cryptographic Hashes
Nonces
Hash value*
+ Nonce
New hash value
TRANSACTION VERIFIED
Bob & Alice

Conclusion

Cryptocurrency is an impressive technical achievement, but it remains a monetary experiment. Even if cryptocurrencies survive, they may not fully displace fiat currencies. As I have tried to show in this presentation, they provide an interesting new perspective from which to view economic questions surrounding currency governance, the characteristics of money, the political economy of financial intermediaries, and the nature of currency competition.

References

- https://thefutureofpayments.blog/ (April 20, 2017)
- https://www.youtube.com/watch?v=Gc2en3nHxA4 (April 19, 2017)
- https://en.wikipedia.org/wiki/Cryptocurrency (April 17, 2017)
- Milne, Alistair, Cryptocurrencies from an Austrian Perspective (April 17, 2017). Available at SSRN: https://ssrn.com/abstract=2946160 or http://dx.doi.org/10.2139/ssrn.2946160
- Reid, F. & Harrigan, M. (2013) An Analysis of Anonymity in the Bitcoin System. Security and Privacy in Social Networks. Available at: http://link.springer.com/chapter/10.1007/978-1-4614-41397_10
- Nakamoto, S. 2008. Bitcoin: A Peer-to-Peer Electronic Cash System. bitcoin.org. https://bitcoin.org/bitcoin.pdf.

THANK YOU!

PRESENTATION ON CUSTODIAL SERVICES

Introduction

Financial services are the economic services provided by the finance industry, which encompasses a broad range of organizations that manage money, including banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and Government sponsored enterprises.

Meaning of Custodial Services

- It is one of the financial services in which a brokerage or other financial institution holds and manages a client's securities or other assets on their behalf.
- A custodian provides an investor a place to store assets with little risk. This reduces the risk of the client losing their assets or having them stolen. They are also available to sell through the brokerage at the client's demand.
- The custody business provides a range of security services, like safekeeping and settlement, dividends collection and distribution, proxy voting, tax reclaim services, fund administration and providing market news


Kotak Mahindra
kotak
Kotak Mahindra Bank

Name of the Company	Kotak Mahindra Finance Limited
Year of Establishment	1985
Headquarters	Mumbai, India
CEO	Mr. Uday Kotak
Industry	Financial Service
Sector	Public

- Kotak Group, a premier financial services provider and one of the leading private sector banks in India, proudly launches Custody Services as part of its diversified services portfolio in capital markets industry. A dedicated team of experienced professionals and emphasis on the latest state of the technologies have made Kotak Group being at the forefront of financial products and services in Indian capital markets for overseas and domestic investors.

- The Custody Services division at Kotak Mahindra Bank Ltd., (KMBL) is committed to delivering top of the securities services to institutional investors, both foreign and domestic, that would be investing in the Indian capital markets across debt and equity instruments, derivatives, Depository Receipts and mutual fund units.

- **Key Features**
- Custody and Settlement Services
- Depository Receipts
- Escrow Accounts
- Foreign Direct Investment
- Internet Interface for Clients

Custodian Services provided by KMBL

1. **Account Opening:** Kotak Mahindra Bank would assist clients for the custody account opening documentation requirements and facilitate clients during the SEBI registration process.
2. **Securities Safekeeping:** Provides safekeeping services for securities held - both in electronic as well as physical forms
3. **Corporate Actions:** KMBL custody tracks for corporate actions processing on behalf of its clients. This involves application made to issuers on behalf of clients, income collection and following-up for corporate action events like dividend, interest, redemption, bonus, rights etc.

4. **Foreign Exchange Services:** KMBL has a dedicated foreign exchange desk that takes care of client needs for currency conversions and risk management products.
5. Proxy Services: KMBL would act on client instructions and participate and vote on their behalf in shareholders' meetings of companies.
6. **Compliance Monitoring and Regulatory Reporting:** KMBL would monitor compliance to existing guidelines by investors and facilitate reporting to regulators and local authorities on behalf of the client.
7. **Transaction Settlement:** As a Clearing Member with the clearing houses of leading Indian Stock Exchanges (NSE & BSE), KMBL,

8. **Standardized and Customized Reporting:** Investors need meaningful information that offers insight to their investment portfolios. It also provides customized reports to clients at various frequencies to enable clients to efficiently manage their securities portfolio, cash balances and take more informed investment decisions.

THANK YOU

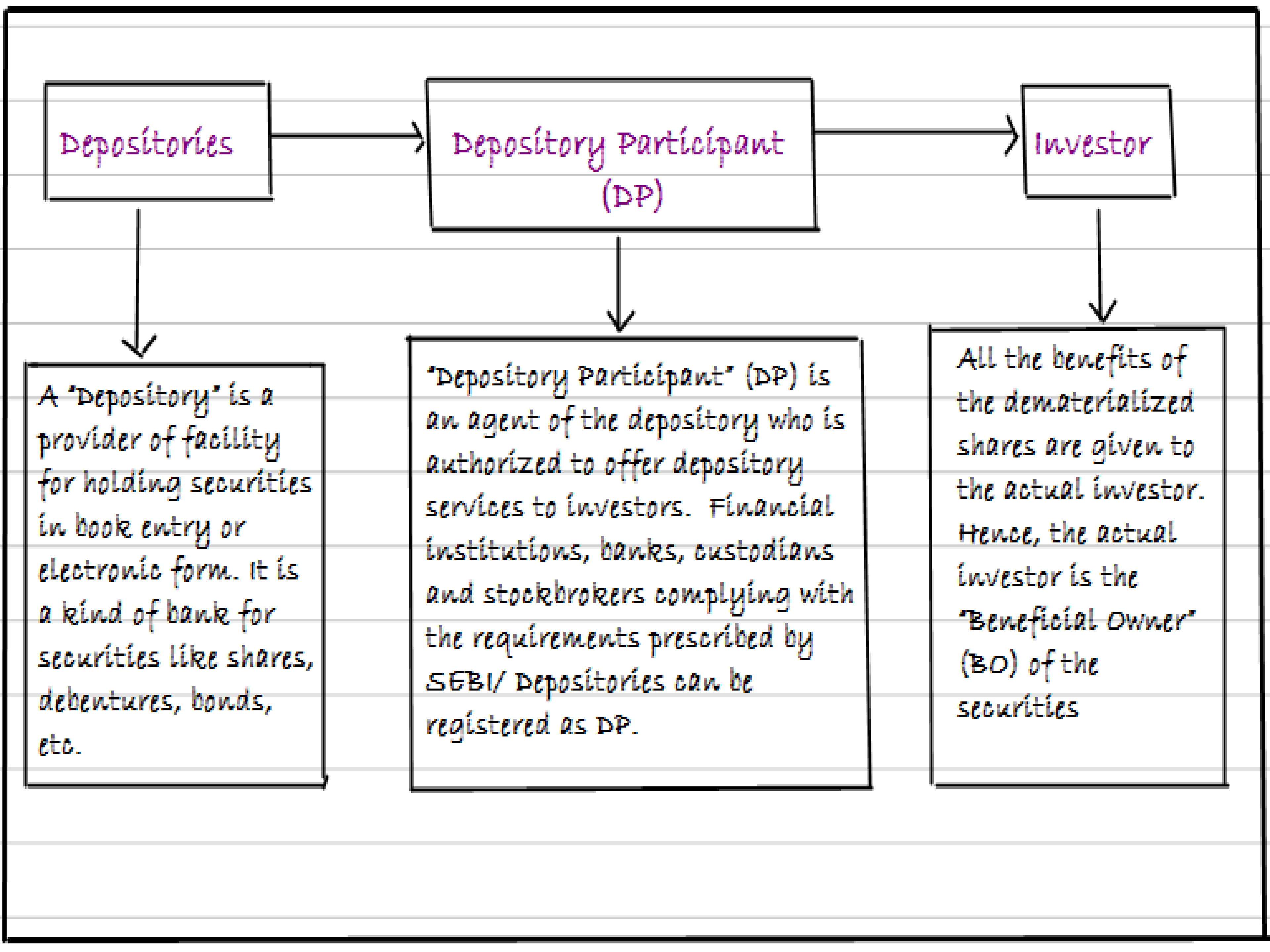
Depository Services

Index

- Depository Service
- Depository Participants
- Depositories
- Who provide depository service & Depositors in India
- How depositories work?
- Book entry system

What is Depository Services?

- Depository services related to various transactions in such securities.
- A depository interfaces with its investors through Depository Participants.
- **Depository Participants** maintain investors' accounts (demat accounts) which are similar to Savings Bank/Current accounts with a Bank.
- Purchase and sale of securities can be done through demat account.


Depositories
Depository Participant (DP)
Investor
A 'Depository' is a provider of facility for holding securities in book entry or electronic form. It is a kind of bank for securities like shares, debentures, bonds, etc.
'Depository Participant' (DP) is an agent of the depository who is authorized to offer depository services to investors. Financial institutions, banks, custodians and stockbrokers complying with the requirements prescribed by SEBI/ Depositories can be registered as DP.
All the benefits of the dematerialized shares are given to the actual investor. Hence, the actual investor is the 'Beneficial Owner' (BO) of the securities

Depositories

- A Depository **facilitates holding of securities** in the **electronic** form and **enables securities transactions** to be processed by **book entry.**

Who are Depository Participants ?

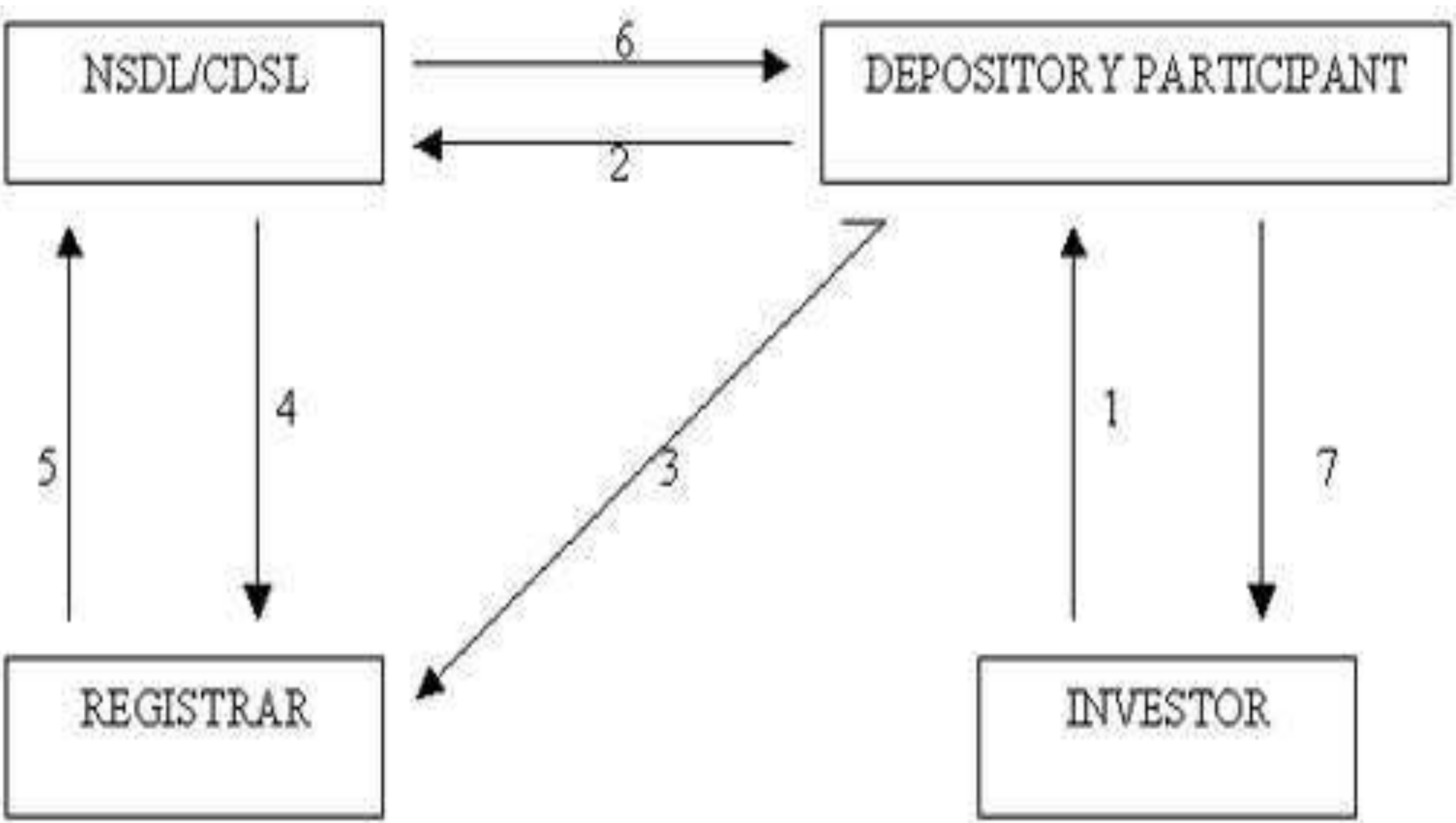
- *A Depository Participant* (DP) is an **agent** of the **depository** who is **authorized** to offer **depository services to investors**.

- Financial institutions, banks, custodians and stockbrokers complying with the requirements prescribed by SEBI/ Depositories can be registered as **DP.**

Book entry system

- **Book entry system is a system under which no physical transfer of securities takes** place. In case of change of ownership rights, securities do not change hands physically.
- To facilitate the change of name/ownership rights, merely a book entry is passed.
- Since, the securities are fungible; transfer becomes easier.

How Depository service work?



Who provide Depository Services & Depositors in India

- NSDL
- CDSL

National Securities Depository Limited (NSDL)

- **National Securities Depository Limited (NSDL) does the above tasks for the trades**
- done on NSE. It is a joint venture of:
- IDBI (Industrial Development Bank of India Limited);
- NSE (National Stock Exchange); and
- UTI (Unit Trust of India).

- NSDL is the first depository to be set up in India. It was registered by SEBI on June 7, 1996.

Central Depository Services Limited (CDSL)

- The second depository **Central Depository Services Limited (CDSL) has been** promoted by Bombay Stock Exchange and Bank of India.
- It was formed in February 1999.

- Both depositories have a network of Depository participants (DPs) which are further electronically connected to their clients.
- So, DPs act as a link between the depositories and the clients.

- The **Depository system to some extent works like the banking system.**
- **There is a** central bank and the rules and regulations related to the working of all the commercial, foreign, co-operative and other types of banks are framed by the central bank.
- In order to do the daily transactions, the investors open an account with the associate banks, and not with the central one.
- Like an investor can have a bank account with more than one bank, similarly one can have more than one Demat Account.


THANK
YOU

What is Stock Broking?

Stock Brokers

- Is a member of a recognized stock exchange who buys, sells or deals in securities.
- As a member of stock exchange , will have to abide by its rules, regulations , bye-laws, pay the fee, and take steps for addressing investors grievances.
- Registration : has to apply through the stock exchange where is a member, who then forwards to SEBI within 30 days of its receipt.
- **Fees** : registration fee on the annual turnover to be paid to SEBI. Annual Turnover **up to Rs. 1 crore, Rs.5000**, Annual turnover in **excess of 1 crore, Rs.5000+one hundredth of 1%of the turnover in excess of Rs.1 crore** for each financial year.
- **Code of conduct** as specified to be followed.

Stock Brokers… regulatory framework

- **General Obligations and Responsibilities:**
- - has to maintain books of accounts , records w.r.t. a) Register of Transactions (*sauda book*) b) Documents register containing records relating to receipt/delivery of securities in physical form and those provided by depository participant. C) Journals d) Cash book e) Member's contract book - Member's contract book showing details of contract's entered into with him , f) Margin Deposit book g) Registers of sub broker accounts etc.
- Has to appoint compliance officer who will inspect all compliances of SEBI guidelines and report independently to SEBI.
- A stock broker not allowed to deal with a sub broker, who is not registered with SEBI.


THE U
ONE DOLLAR

Stock Brokers……regulatory framework

- Liability for Contravention of the SEBI Act –
- monetary penalty under chapter VI-A of SEBI.
  - Penalties as specified by SEBI , including suspension or cancellation of Registration.
  - Prosecution under section 24 of the SEBI Act. (market manipulation, dealing without registration etc, dealing outside recognized stock exchange.)

Capital Adequacy Norms for Brokers

- Base minimum capital -: a min. of Rs.5 lakhs as deposit with stock exchange by members of Mumbai and Kolkatta. Rs.3.5 lakh for Delhi and A' bad stock exchange members. For other stock exchange members Rs. 2 lakhs minimum.
- The security deposit forms part of base minimum capital.
- 25% of base minimum capital to be kept in cash with the exchange. Another 25% as long term fixed deposit(min3yrs) with a bank, whose lien is given to the stock exchange. The remaining requirement to be maintained as securities.
- The securities to be pledged with the stock exchange.

Capital Adequacy norms for brokers..

- Additional Capital Related to Volume of Business :
- Additional Capital should be such that with base minimum it should not be less than 8% of the Gross outstanding business in the stock exchanges.
- Outstanding business is aggregate of up to date purchases and sales by the broker in all securities put together.(no netting of sales and purchases allowed).
- Gross outstanding business , should not exceed 12.5 times the base and additional capital.
- If outstanding business exceeds 12.5 times , then Broker should then not increase his business until additional capital is brought into his business and stock exchange permits further trading.

Monitoring Requirements..

- Should inform the stock exchange regarding the compliance of additional capital, every quarter end , with an auditor's certification.
- Has to inform the stock exchange, if the outstanding position is 10 times of their base capital and additional capital.
- Failure to comply with Capital Adequacy Requirement invites, penalties, suspension from trading.

Sub brokers

- Sub brokers : acts on behalf of the stockbroker as an agent for assisting investors in buying and selling of securities.
- - not a member of stock exchange, but registered with SEBI.
- Separate registration with SEBI, for sub broking contract for each broker.
- Compliance includes payment of fees, adequate steps for redressal of investor grievances and reporting of the same to SEBI.

Thanks

Stock Broker

A stock broker is an individual usually associated with a stock brokerage firm. Their general job role is the selling of stock (share, securities, options) on behalf of a client via a stock exchange.

- This service (brokerage) costs a commission fee which enables stock brokerage firms o accrue profit.
- Stock brokers often, also give financial advice to institutional, commercial, or private clients that they work with in order to counsel their clients on where best to spend their money with a view of gaining the highest financial gain/return.

- Stock brokers are essentially a middle man between a buyer and a seller of stock (shares, securities, options).
- The concept is that these people with greater knowledge of the wider market can facilitate the best deals without individuals having to locate one another privately.

- Clients use the middle man as a way to draw out their expertise in order to invest a certain sum of money with the intention of creating a larger sum of money through this original investment.
- Stock brokers are the brains that hold the knowledge of which areas financially viable for increasing revenue/gain/profit/earnings.

- This knowledge incites investments which help to generate competition and activity within the stock market.
- They are the “enablers” that allow the stock market to run smoothly.

Types of stock brokers

- There two main types of stock brokers:
- Full-service brokers and discount brokers.
- Full-service brokers are more expensive to hire and often earn a good amount of brokerage/ fee/commission/salary.

Reasons for more expensive of full-service brokers

- This is because they not only facilitate and undertake stock deals between clients and sellers, but they also provide financial advice and stock advice in order to steer buyers in the right direction to assist them with closing the worthwhile deals.

Discount brokers

- Discount brokers, however, merely carry out the actual deal between buyers and sellers.
- They do not provide financial advice, whatsoever, and allow their clients to buy whichever stocks they deem to be worthwhile, without the financial assistance of an expert.

- It is vital that both types of stock brokers are present in the stock market.
- They are, first and foremost, a vital tool for ensuring that transactions take place quickly, effectively, and correctly.
- However, discount brokers are as important as full-service brokers.

- With the general population having the option of making their own decisions, it allows the market to grow as the balance of good decisions and bad decisions among the unadvised traders enables the wining and losing within the market and keep the wind of competition

Asset Management firms

- Asset Management firms often work with clients in order to help them achieve the greatest return on their assets.
- This includes investing those assets in order to try and increase their worth. These firms use stock brokers to make the decisions on investing these assets, along-with maintaining the accounts of the clients who are having their assets managed.

- It is the role of stock broker in these companies to try to make correct decisions which will be financially viable to clients by increasing their assets and subsequently their worth or the worth of the client company.

Private client stock brokerages

- They simply work with private clients in helping them to invest their money on the stock market with the view of returning revenue higher than the invested amount.
- These companies use both full-service stock brokers, to provide advice to clients looking to invest their money wisely, as well as using discount brokers in order to undertake the physical transactions with providing the advice.

Investment banks

Investment banks also employ/engage stock brokers, and this is probably one of the most competitive fields to enter. Investment bankers are essentially stock brokers; however, not all stock brokers are investment bankers.

Investment banking often gains very high salary and basically focuses on helping companies, institutions, government departments, and rich individuals to manage their wealth and investments in order to return bigger revenue.

- Often this involves selling stocks and shares in order to afford for a company to proceed and to finance their business activity.
- Usually investment bankers earn the highest salary of all stock brokers/ staff engaged by them.
- However, this is very much dependent on which company they work for and which clients they have.

Stock Broking

Stock Brokers

- A stock broker is a member of a recognized stock exchange, who buys, sells or deals in securities.
- A certificate of registration from SEBI, is mandatory to act as a broker.
- SEBI is empowered to impose conditions while granting the Certificate.

As a member of the Stock Exchange

- He will have to abide by its rules, regulations and bye laws,
- Pay the prescribed fee
- Take adequate steps for redressal of investor grievances within one month of the receipt of the complaint
- Keep SEBI informed about the number, nature and other particulars of such complaints.

Registration

- Has to apply through the stock exchange of which he is a member.
- The application must be forwarded by the exchange to SEBI within 30 days from the date of receipt.
- The exchange should also include a statement to the effect that no complaints/arbitration cases are pending against the applicant.

For granting Registration

- SEBI checks whether or not he is eligible to be member of a stock exchange
- Has the necessary infrastructure including manpower to discharge his activities
- Has past experience in the business of buying, selling or dealing in securities
- Whether there are any disciplinary proceedings against him by the stock exchange.

Payment of Fees

- Rs 5000 plus 0.0001 per cent of his turnover in excess of Rs 1 Crore.

Code of Conduct

- Registered stock brokers have to abide by a code of conduct.

Appointment of a compliance officer

- Every stock broker should appoint a compliance officerto monitor the compliance of SEBI regulations etc
- He should immediately and independently report any non compliance observed by him to the SEBI.

Not to deal with unregistered sub-broker

- A stock broker should not deal with any person as a sub broker unless he has obtained a certificate of registration from the SEBI.

Inspection and Penalties

- SEBI is empowered to inspect the books of accounts and documents of the stockbroker.
- A stock broker or sub broker who contravenes any of the provisions of SEBI Act, rules or Regulations is liable for penalty.

Capital Adequacy Norms

1. Base Minimum Capital
2. Additional/Optional Capital

Base Minimum Capital

- An absolute minimum of Rs 5 lakhs should be maintained as deposit with the stock exchange by member brokers of Mumbai and Kolkata stock exchanges.
- Rs 3.5 lakhs by those of Delhi and Ahmedabad exchanges
- Rs 2 lakhs – Minimum requirement for other stock exchanges

Additional/Optional Capital

- Not less than 8 per cent of the gross outstanding business in the stock exchange defined as the aggregate of up to date sales and purchase by member broker in all the securities put together.

- On the outstanding Business reaching 10 times the base and additional capital, a broker has responsibility to intimate the stock exchange.
- If the outstanding business reaches 12.5 times the base and additional capital, the member should not increase his outstanding business until additional capital has been brought into his business and the stock exchange is satisfied that the member could be allowed to trade further.

Clients and Brokers

- All brokers must keep their own money and money of the clients in separate accounts.
- Brokers have to make payment to their clients / deliver the securities purchased within two working days of payout unless the client desires otherwise.

- They can buy securities for clients only on receipt of 20 per cent margin on the price of the securities proposed to be purchased.
- The broker must issue the contract note for purchase/sale of securities to a client within 24 hours of the execution of the contract.

Sub Brokers

- A sub broker acts on behalf of a stock broker as an agent or otherwise for assisting investors in buying, selling or dealing in securities through such brokers, but is not a member of the stock exchange.
- Sub Brokers wanting to do Business with more than one broker need to be separately registered with the SEBI for each broker.

Foreign Broker

- A foreign Broker can operate only on behalf of Registered FIIs.
- He cannot deal in securities on his own account as principal.

Stock Market (Cash/Normal) trading through NSE.)

- India has a history of stock exchanges limited in their operating jurisdiction to the cities in which they were set up.
- The NSE represented an attempt to overcome the fragmentation of regional markets by providing a screen based system that transcends geographical barriers.

Objective

- To set up a nationwide trading facility for equities, debt instruments and hybrids.

The NSE has three segments for cash trading in securities:

- The Wholesale Debt Market
- Capital Market
- Trading in Central Government Securities.

Wholesale Debt Market Segment

- Provides a facility for institutions/body corporates (institutional Investors) to enter into High value transactions in instruments such as Government Securities, T-Bills, PSU Bonds, units of mutual funds, Certificates of Deposits, Commercial Papers and so on.

Capital Market Segments

- Provides an efficient and transparent platform for trading of equity and Preference shares, debentures, warrants, coupons and exchange traded funds.
- This segment started trading in November, 1994.

Trading Mechanism

- The trading system is known as the National Exchange for Automated Trading (NEAT).
- Online, fully automated, order driven, screen based trading system where a member can punch into the system quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from a counterparty.

Derivatives trading

- The SEBI set up LC Gupta committee on November 18, 1996 to develop appropriate regulatory for derivatives trading in India.
- The committee submitted its report on March 17, 1998.
- The Securities Contracts Regulations Act was amended in December, 1999 to include Derivatives within the ambit of Securities.

- Derivatives Trading commenced in India in June, 2000 after SEBI granted the final approval to this effect in May, 2001.
- It permitted the derivative segment of two stock exchanges, NSE and BSE and their clearing house/corporation to commence trading and settlement in the derivative segment of two stock exchanges.

- To begin with, it approved trading in index futures contracts based on NIFTY and Sensex.
- The trading in Index options commenced in June 2001 and in options on individual securities commenced in July, 2001.
- Futures contracts on Individual stocks was launched in November, 2001.

- Exchange traded interest derivatives contracts have been introduced with effect from June, 2003.

Clearing and Settlement

- The National Securities Clearing Corporation Limited undertakes clearing and settlement of all trades executed on the F&O segment of the NSE. It also acts as a legal counterparty to all trades and guarantees their final settlement.
- All futures and Options contracts are cash settled.

Questions for Revision

- Write short notes on
  1. Stock Broking
  2. NSE

PRESENTATION ON NATIONAL HOUSING BANK (NHB)

INTRODUCTION TO HOUSING FINANCE

- It refers to finance that is provided to individuals or group of individuals including co-operative societies for purchase/build house or houses.
- Housing Finance refers to the finance for meeting the various needs related to housing:
- Purchase of land
- Acquisition of a Flat
- Construction of a house
- Extension of a house
- Housing loans from other banks/HFCs.

PURPOSE & QUANTUM

- Purpose :

- It provides for :

- Purchase of flat / house or purchase of plot of land.
- For renovation / repairs of an existing house/ flat.
- For extending an existing house.
- Short term bridge finance while purchasing another house/ flat.

CONTINUED….

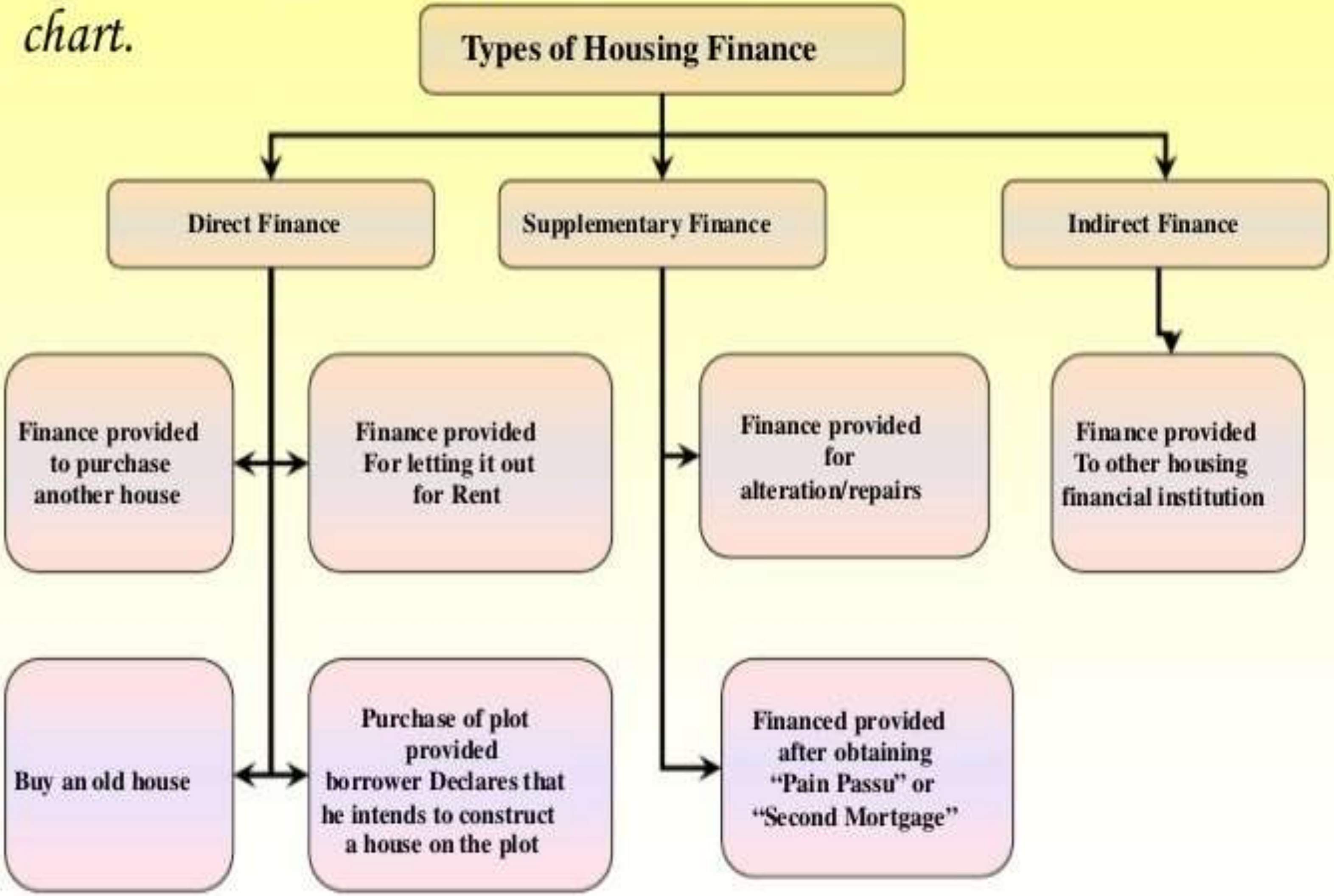
- <u>Quantum</u> :
- The Quantum of loan varies from bank to bank normally bank stipulate minimum of Rs. 1 lakh.
- The maximum would depend on the bank and it could vary from Rs. 10 lakhs to Rs. 2 crores or more.
- For repairs the amount is less i.e around Rs. 10 lakhs.

INTEREST RATE AND SECURITY FOR HOUSING LOAN

- For housing loan, there are two types of interest rate:
- **fixed** - for entire tenure of the loan
- **floating** - which is changing through out the duration of loan.
- The security in respect of housing finance is the property purchase with a mortgage is taken on the same.
- For additional security guarantee may be taken.

Types of Housing Finance

The different types of Housing Finance are shown in the chart.



DIRECT HOUSING FINANCE

- It refers to the finance provided to individuals or groups of individuals including co-operative societies.
- Under this category, the following types of bank finance are included :
  - Bank finance extended to a person who already owns a house in town/ village where he resides, or for buying / constructing a second house in the same or Other town / village for the purpose of self - occupation.
  - Bank finance extended for the purchase of a house by a borrower who proposes to let it out on rental basis on account of his posting outside the headquarters or because he has been provided accommodation by his employer.

CONTINUED….

- Bank finance extended to a person who proposes to buy an old house where he is presently residing as a tenant.
- Bank finance granted only for purchase of a plot, provided a declaration is obtained from the borrower that he intends to construct a house on the said plot, with the help of bank finance or otherwise, within such period as may be laid down by the banks themselves

SUPPLEMENTARY FINANCE

- Banks may consider requests for additional finance within the overall ceiling for carrying out alterations / additions / repairs to the house / flat already financed by them.
- In the case of individuals who might have raised funds for construction / acquisition of accommodation from other sources and need supplementary finance, banks may extend such finance after mortgaging charge over the property mortgaged in favor of other lenders and / or against such other security, as they may deem appropriate.

INDIRECT HOUSING FINANCE

- The Banks ensures that their indirect housing finance is channeled by way of term loans to housing finance institutions, housing boards, other public housing agencies, etc primarily for augmenting the supply of serviced land for the constructed units.
- It should also be ensured that the supply of plots / houses is time bound and public agencies do not utilize the bank loan merely for acquisition of land.

INTRODUCTION TO NATIONAL HOUSING BANK (NHB)

- The National Housing Bank (NHB) was set up on July 9, 1988 under the National Housing Bank Act, 1987 as the Apex level institution for housing finance.
- To promote the housing financial institutions both at local and regional levels.
- The NHB is wholly owned by the RBI which has contributed the entire paid-up capital.
- Ensures a sound and healthy housing finance system through effective regulation and supervision of housing finance institutions.

OBJECTIVES OF NHB

- To promote a sound, healthy, viable and cost effective housing finance system to cater to all segments of the population.
- To integrate the housing finance system with the overall financial system.
- To promote a network of dedicated housing finance institutions to adequately serve various regions and different income groups.
- To augment resources for the sector and channelize them for housing.
- To make housing credit more affordable.

CONTINUED….

- To regulate the activities of housing finance companies based on regulatory and supervisory authority derived under the Act.
- To encourage augmentation of supply of buildable land and also building materials for housing and to upgrade the housing stock in the country.
- To encourage public agencies to emerge as facilitators and suppliers of served land, for housing.

FUNCTIONS OF NHB

- Promotion and Development Function
- Regulatory Function
- Financing Function

PROMOTION AND DEVELOPMENT FUNCTION

- NHB has designed and conducted the various training programmes considering the need for trained persons.
- The NHB also contributes to improve or strengthen credit delivery network for housing finance in the country.
- As a part of this role, NHB has framed a scheme for guaranteeing the bonds to be issued by the housing finance company.
- NHB operates as a multifunctional Development Finance Institution (DFI) for the housing sector.

CONTINUED….

NHB has been financing the following housing schemes at all India level:-

- Indira Awas Yojna
- Golden Jubilee Rural Housing Finance Scheme
- Bharat Nirman
- Productive Housing in Rural Areas(PHIRA)
- 1% Interest subvention scheme

REGULATORY FUNCTION

- According to NHB Act, 1988, NHB is expected to regulate the housing finance system of the country to its advantage.
- To prevent any housing finance institutions being conducted in such a manner which may be against the interest of depositors or of the housing finance institutions.
- For this purpose, NHB has been given power to determine the policy.
- To give directions to the housing finance institutions and their auditors.

FINANCING FUNCTION

- To provide financial assistance to various banks and housing finance institutions.
- The financing of housing sector by the NHB is done by extending refinance to different primary lenders in respect of:
- Eligible housing loans extended by them to individual beneficiaries.
- For project loans extended by them to various implementing agencies.
- Acting as special purpose vehicle for securitizing the housing loan receivables.

HOUSING URBAN DEVELOPMENT CORPORATION (HUDCO)

- Housing Urban Development Corporation ltd. established on April 25, 1970
- HUDCO is fully owned by the Government of India .
- HUDCO plays a major role in implementation of National Housing Policy.
- HUDCO offers housing loans for the buying/constructing house/flat & Loans are also offered for renovation/extension/alteration of existing house/flat.
- It is one of the top financing company in India.

OBJECTIVES OF HUDCO

- Provide **long term finance** for construction of house for residential purpose in urban & rural areas.
- To **subscribe to debentures & bonds** issued by the state housing & urban development boards, trusts, authorities etc especially for the purpose of housing.
- To **administrate the amount** received from time to time, from Government of India (GOI) and other sources for the purpose of financing or undertaking housing and urban development programmes in the country.
- To **promote ,establish ,assist ,collaborate** and provide consultancy services for the projects in designing and planning of works relating to housing and urban development.

INSTITUTIONS PROVIDING HOUSING FINANCE

- In India, the following types of institutions provide long term finance for housing:
  - Commercial banks- a bank that offers services to the general public, companies & are the largest mobilizers of savings in the country.
  - Cooperative banks- A bank that holds deposits, makes loans and provides other financial services to cooperatives and member-owned organizations & are apex level institutions of the state cooperative credit structure.
  - Regional rural banks- to serve primarily the rural areas of India with basic banking and financial services & are allowed to lend for financing.

CONTINUED….

- <u>Agriculture and rural development banks</u>- these are term lending institutions operating exclusively in the rural sector & reaches out to allied economies and supports & promotes an integrated development.
- <u>Housing finance companies</u>- these are non banking financial companies which should form a major share of the company's assets
- <u>Cooperative housing finance societies</u>-these are specialized housing finance which is used to support and help the housing needs of community at large.

CONCLUSION

- Housing Finance sector is set to see higher growth in next few years, with an increase in the demand and supply of housing projects.
- HUDCO plays a major role in implementation of National Housing Policy. 44.33% of housing loan of HUDCO has been allocated for Economically Weaker Section (EWS) and Low Income Group (LIG).
- NHB operates as the principle agency for promoting, regulating and providing financial and other support to HFCs at local and regional level.

THANK YOU

Microfinance

An emerging asset class?


MICROFINANCE ORGANISATION
REACHING POOR PEOPLE
REPAY-MENT RATES
COST-EFFECTIVE-NESS
EMPOWER-MENT
CLIENT SATISFACTION
BUSINESS DEVELOP-MENT
STAFF PRODUCT-IVITY
SKILLS DEVELOPMENT
MADDOCKS

A solution to end poverty?
Or
An emerging asset class?

Overview

- Philosophy of micro finance
- Major centers of micro finance
- Risks and Limits
- Financing of MFIs
- Financial data
- Conclusion

What is Microfinance?

- Finance that is provided to unemployed or low-income people or groups.
- The provision of small loans (microcredit) to poor people to help them engage in productive activities or grow very small businesses. The term may also include a broader range of services, including credit, savings, and insurance.
- Microcredit is the extension of very small loans to those in poverty designed to spur entrepreneurship.

Who are microfinance clients?

- Microfinance is provided for the people who do not qualify for the banking system.
    - NO collateral (even if people own land they usually don't have the title to it)
    - NO credit history

– Majority of the microfinance clients are women (more than 90% of microcredit is borrowed by women)

How poor are these people?

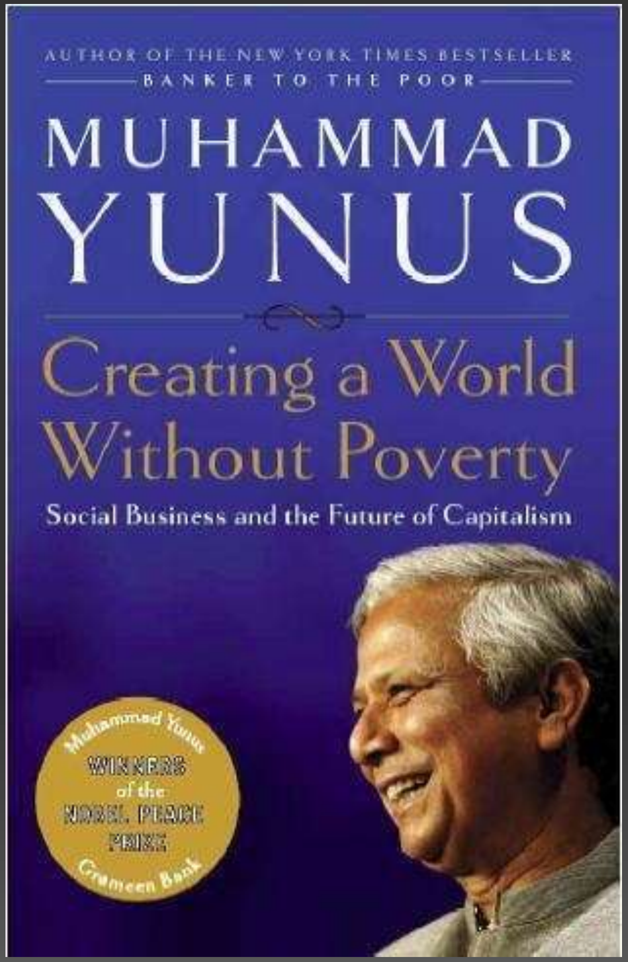
Why do poor people need financial services?

- Lifecycle Needs: such as weddings, funerals, childbirth, education, homebuilding, widowhood, old age.
- Personal Emergencies: such as sickness, injury, unemployment, theft, harassment or death.
- Disasters: such as fires, floods, cyclones and man-made events like war.
- Investment Opportunities: expanding a business, buying land or equipment, improving housing, etc.

Brief History of Microfinance

- In 1976, Muhammad Yunus (Nobel Peace Prize Winner 2006) noticed that small amounts of loans could make a big impact on the poor peoples' lives.

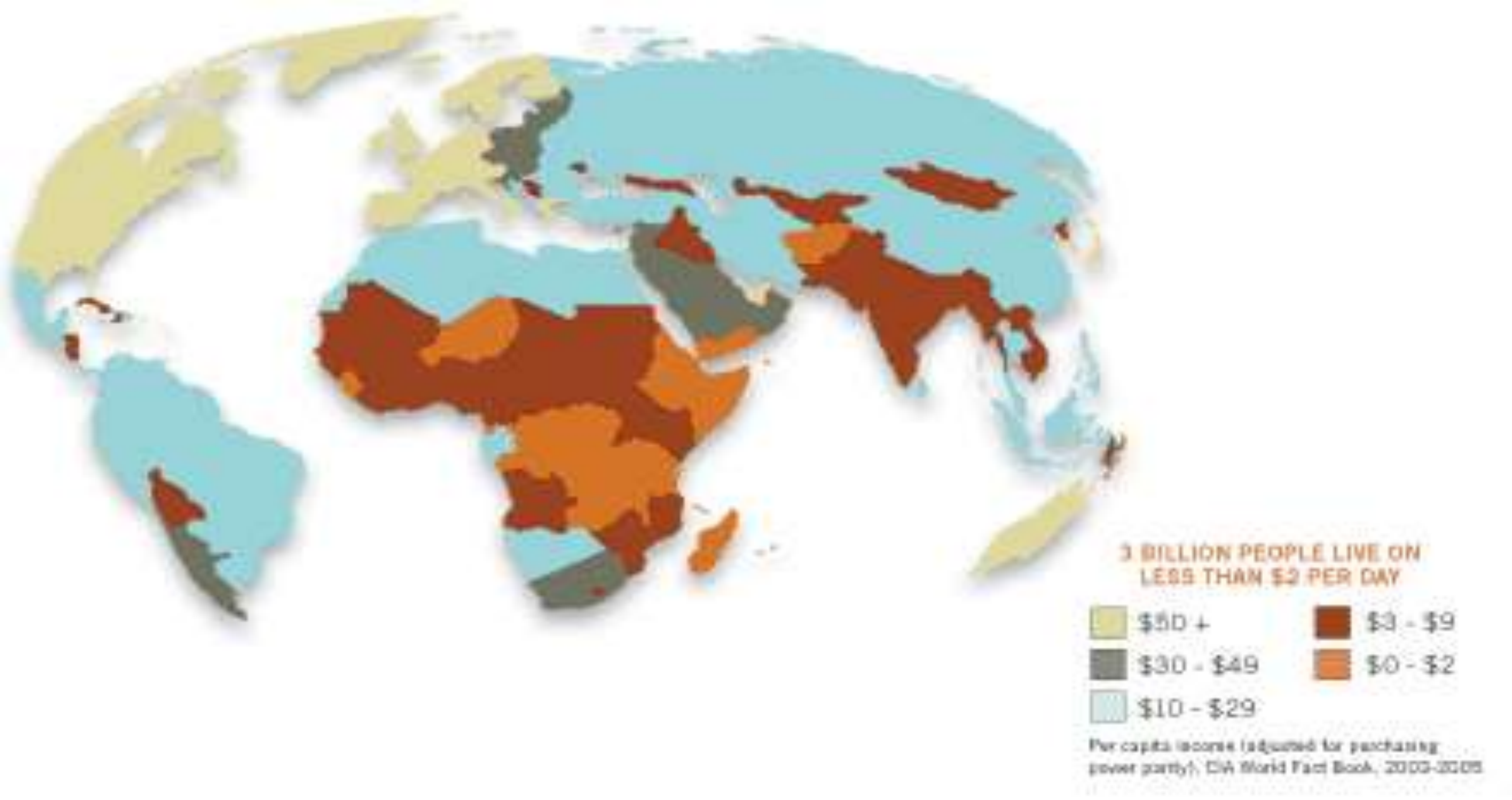
- Grameen Bank, ("Bank of the Villages", in Bangla) was founded in 1983, was supported by the central bank of Bangladesh.



How does Microfinance work?

- System of “microloans” (typically less than $100)
- Instead of using collateral to gain credit, loans are secured against the honour of a peer group: if one person fails to make their payments, others in the lending circle will be denied future credit.
- It has outperformed almost all other forms of development lending.
- It is said that microfinance have lifted 100 million people out of poverty over the last three decades.

Major centers of Microfinance



Regional distribution of MFIs

Region	Number of MFIs	% of total	Countries with the most in the region
Africa	69	14%	Ghana (13); Ethiopia (12)
Asia	117	24%	Philippines (37); India (32)
ECA	98	20%	Bosnia (13); Russia (11)
LAC	179	37%	Peru (37); Ecuador (20); Bolivia (17)
MENA	24	5%	Morocco (7); Egypt (6)

Source: Microbanking Bulletin #18

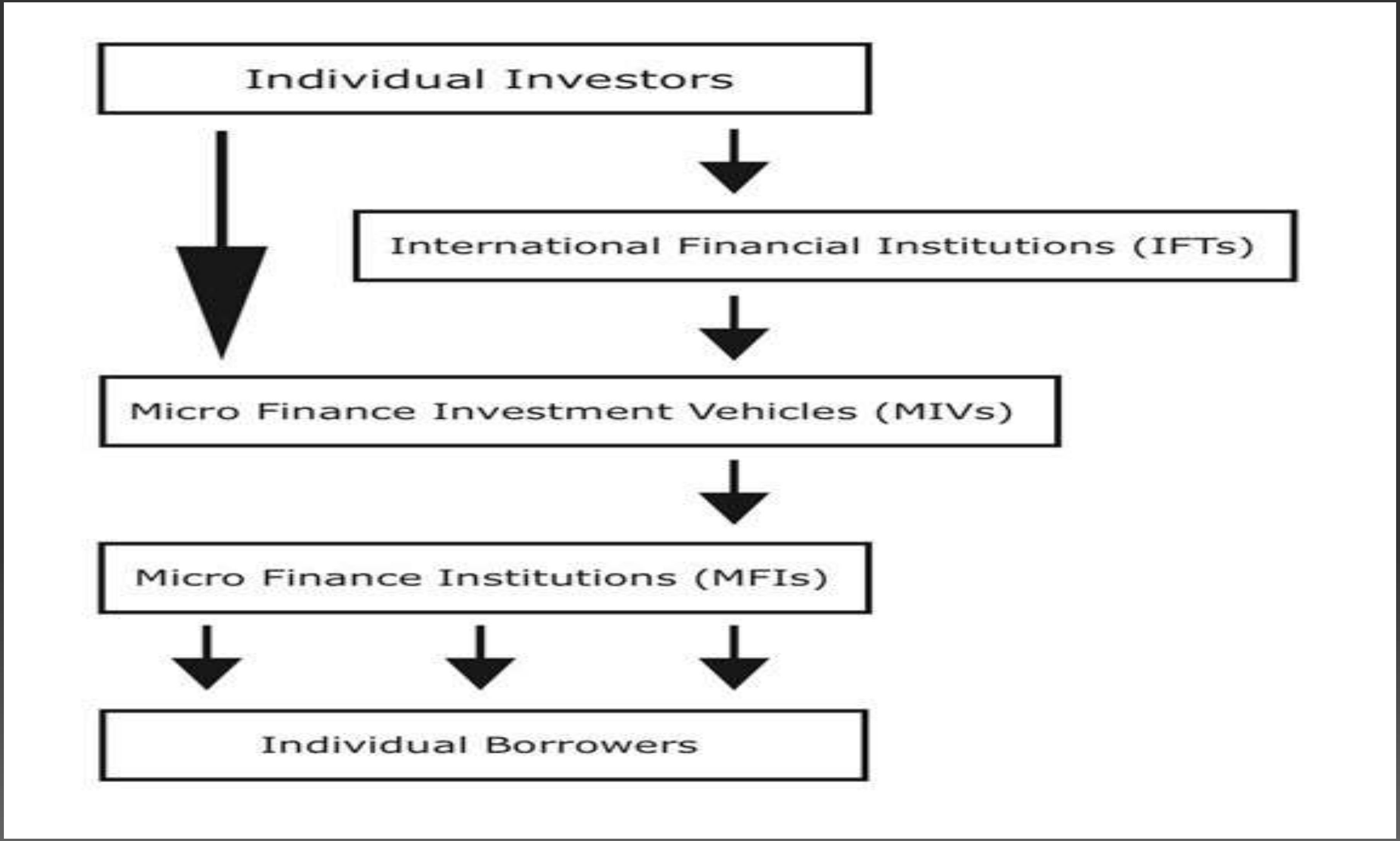
Regional distribution of MFIs

What kind of projects is microcredit used for?

- Microloans are used to help people, living in extreme poverty, start or expand a range of tiny businesses such as husking rice, selling tortillas, and delivering cell phone services to remote villages.

- Diverse “microenterprises” include small retail shops, street vending, artisanal manufacture, and service provision, etc.

Investing in microfinance



MFIs vs. Banks vs. NGOs

"The approach focuses on fostering better repayment discipline and charging interest rates that cover the costs of credit delivery, both of which support development of sustainable institutions that can continue to expand their services in the future.“

- no collateral, credit history required
- sustainability does not depend on donations
- reaching more people
- controversy over interest rates! (when you are thirsty, it doesn't matter whether the water is purified or not)

RISKS:

the returns and risks vary depending on the investment vehicle, and the MFIs in which the fund invests.

1 Foreign Exchange Risk

2Risk Assessment Problem

3- Default risk

4- Volatility

Risks: FX risk

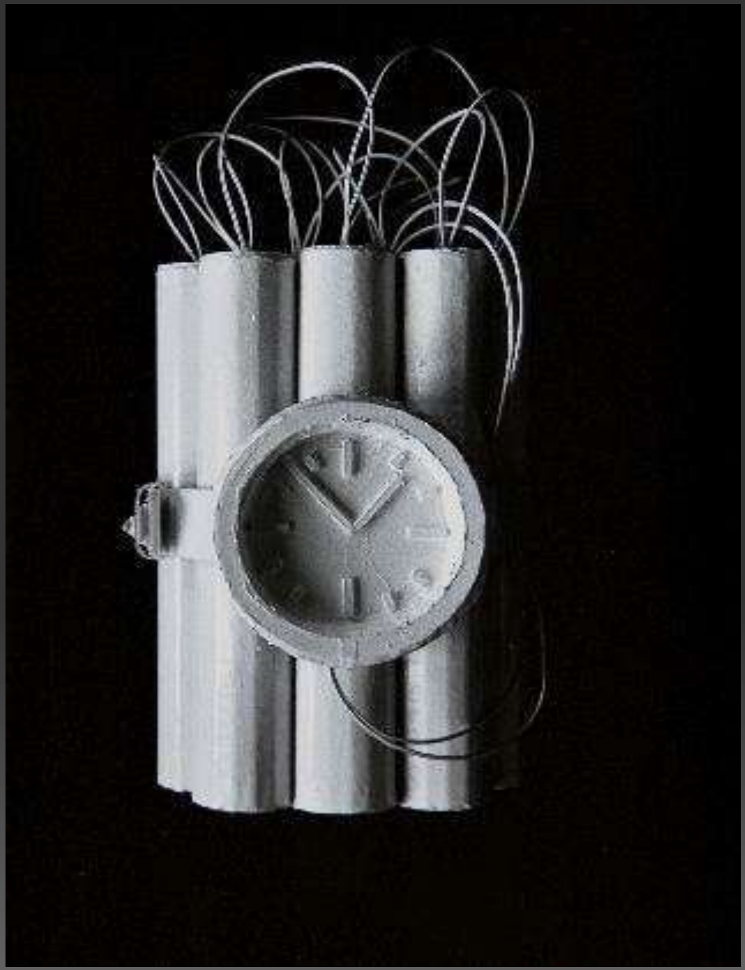
- 92% of the loans to MFIs are denominated in hard currency
- Foreign exchange mismatch
- Some micro finance investments are launching local currency micro finance funds.

Risks: Difficulties in risk assessment

- Rating agencies rating MFIs is good for transparency
- Assessing the credit risk of so many people borrowing tiny, unsecured amounts is not easy

Risks: Default

- No broad consensus about what the real default rates are
- Estimated to be less than 1%



Risks: Volatility

The volatility of MFI returns are lower than commercial banks in those markets because MFI funds are invested in the informal sector, so they don't take macro-economic shocks in those countries on the chin as the banks do

Pension Funds

- Investments by single pension funds typically ranged between .3% and 1% of total assets.
- Hard to justify the dedication of resources in microfinance
- MFVs compete with a wide range of established investment options

Motivations:

- Contribution to the institution's corporate social responsibility
- Portfolio diversification

Pension funds - Concerns

- Long term development of risk
- Lack of experienced microfinance asset managers with a long-enough track-record
- Small number of other pension funds investing
- Small number of consultants recommending microfinance (they probably don't know much about it)
- Reputational risks associated with microfinance being accused of unethical practices in the media (high interest rates)
- Perceived high management fees of microfinance investment funds
- Main concern: limited size and liquidity of the microfinance markets

Attributes of an attractive investment offer

- A broader offer, more choice of different managers and types of products
- Low management fees, professional governance, investment skills and processes, transparency, tax efficiency and reporting
- Better and more professional risk management, including high levels of diversification
- A process to systematically exclude issues of ethical concern from the portfolio

How MFIs are financed

- Financed with combination of debt and equity
- Depends on MFI's access to developed capital markets
- Median for all MFIs in 2007 is a debt to equity ratio of 3.4

Revenues

Yield on gross portfolio, real (%) - Median Values

	2005	2006	2007
All	23.6	23.0	22.2
Africa	22.6	22.2	21.5
Asia	18.3	19.5	18.5
ECA	23.1	21.9	19.6
LAC	26.3	25.2	25.1
MENA	25.5	23.3	25.5

Overall Financial Performance

Return on assets (%) - Median Values

	2005	2006	2007
All	1.0	1.6	1.5
Africa	(1.2)	(0.8)	(0.6)
Asia	0.9	1.2	0.6
ECA	1.4	1.7	1.1
LAC	1.5	2.3	2.1
MENA	2.6	2.4	2.0

Overall Financial Performance II

Return on equity (%) - Median Values

	2005	2006	2007
All	4.4	6.9	7.3
Africa	(4.9)	(1.5)	(0.5)
Asia	4.4	6.8	5.0
ECA	4.4	6.3	6.2
LAC	5.9	8.9	9.3
MENA	5.8	4.9	7.9

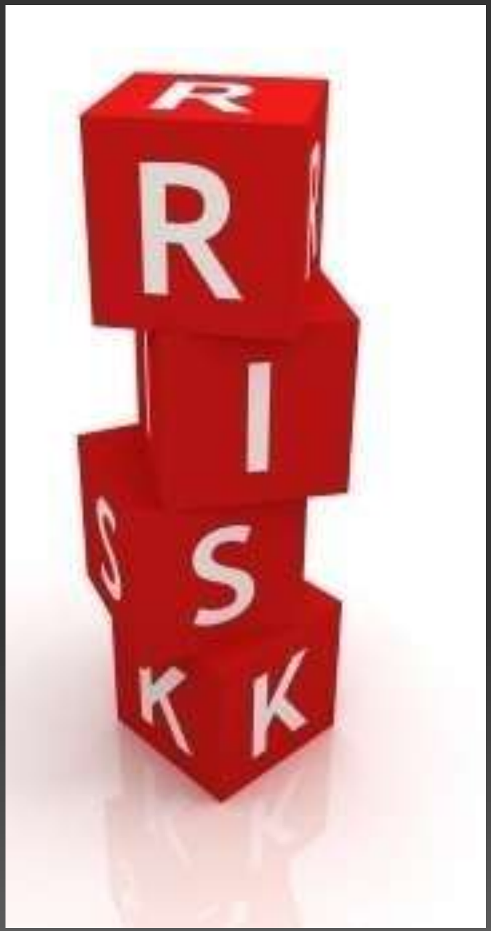
Loans outstanding

Average outstanding balance (USD) - Median Values

	2005	2006	2007
All	474	515	643
Africa	174	241	325
Asia	120	139	164
ECA	1,127	1,404	1,931
LAC	642	684	848
MENA	241	264	345

Risk and Liquidity

Loan loss rate (%) - Median Values



	2005	2006	2007
All	0.9	0.9	1.0
Africa	1.4	1.7	1.5
Asia	0.6	0.7	0.9
ECA	0.4	0.5	0.3
LAC	1.2	1.3	1.7
MENA	0.3	0.2	0.5

Looking forward

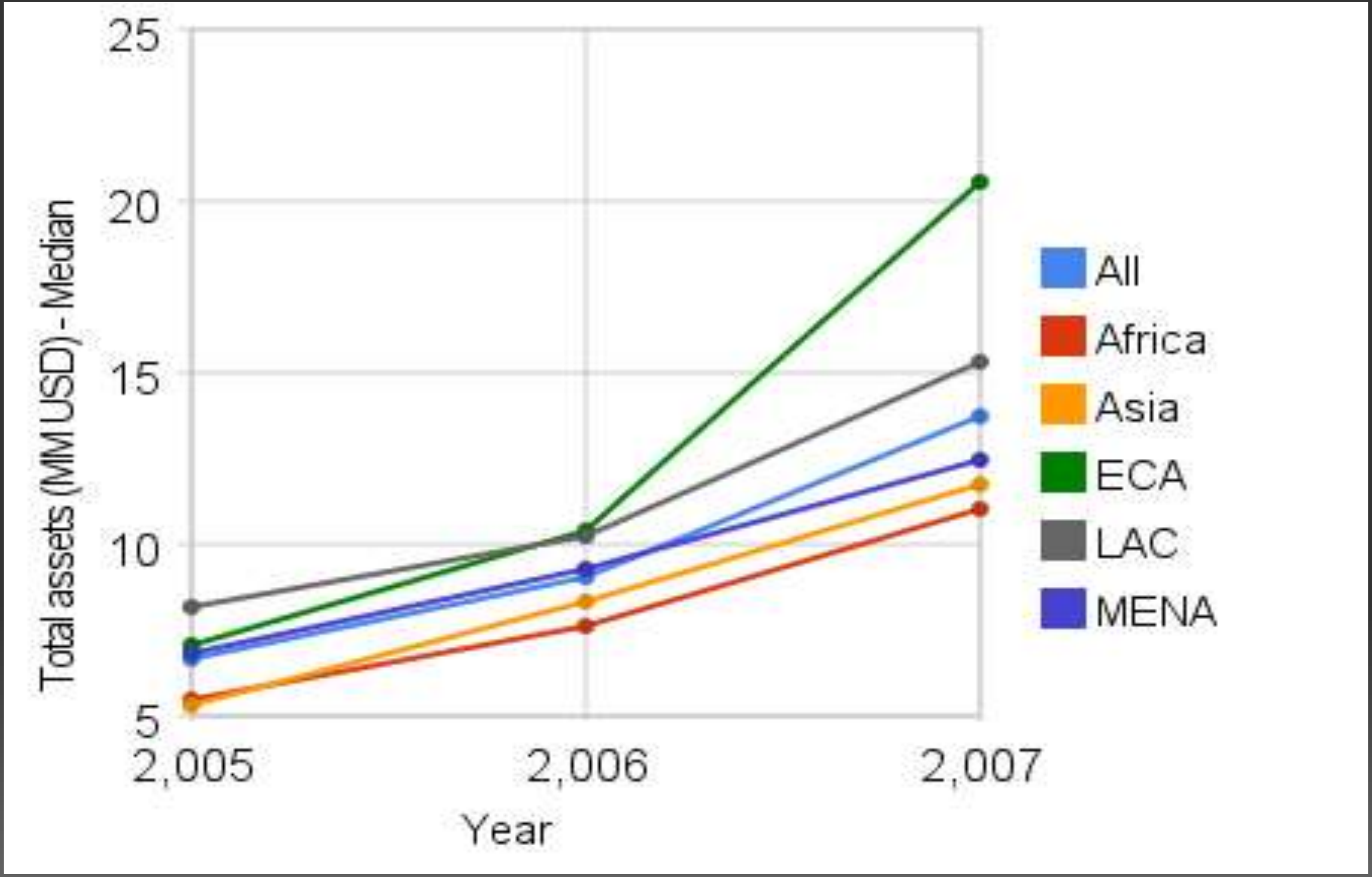
- Industry is expanding significantly
- MFIs popular among European pension and other institutional funds
- One of the few financial sectors not significantly affected by the current recession
- Excellent diversification possibilities
- Way for the financial sector to 'redeem' itself

Expansion of MFIs

Total Assets (MM USD) - Median Values

	2005	2006	2007
All	6.67	9.06	13.72
Africa	5.46	7.6	11.06
Asia	5.32	8.35	11.76
ECA	7.08	10.39	20.59
LAC	8.15	10.2	15.32
MENA	6.84	9.28	12.44

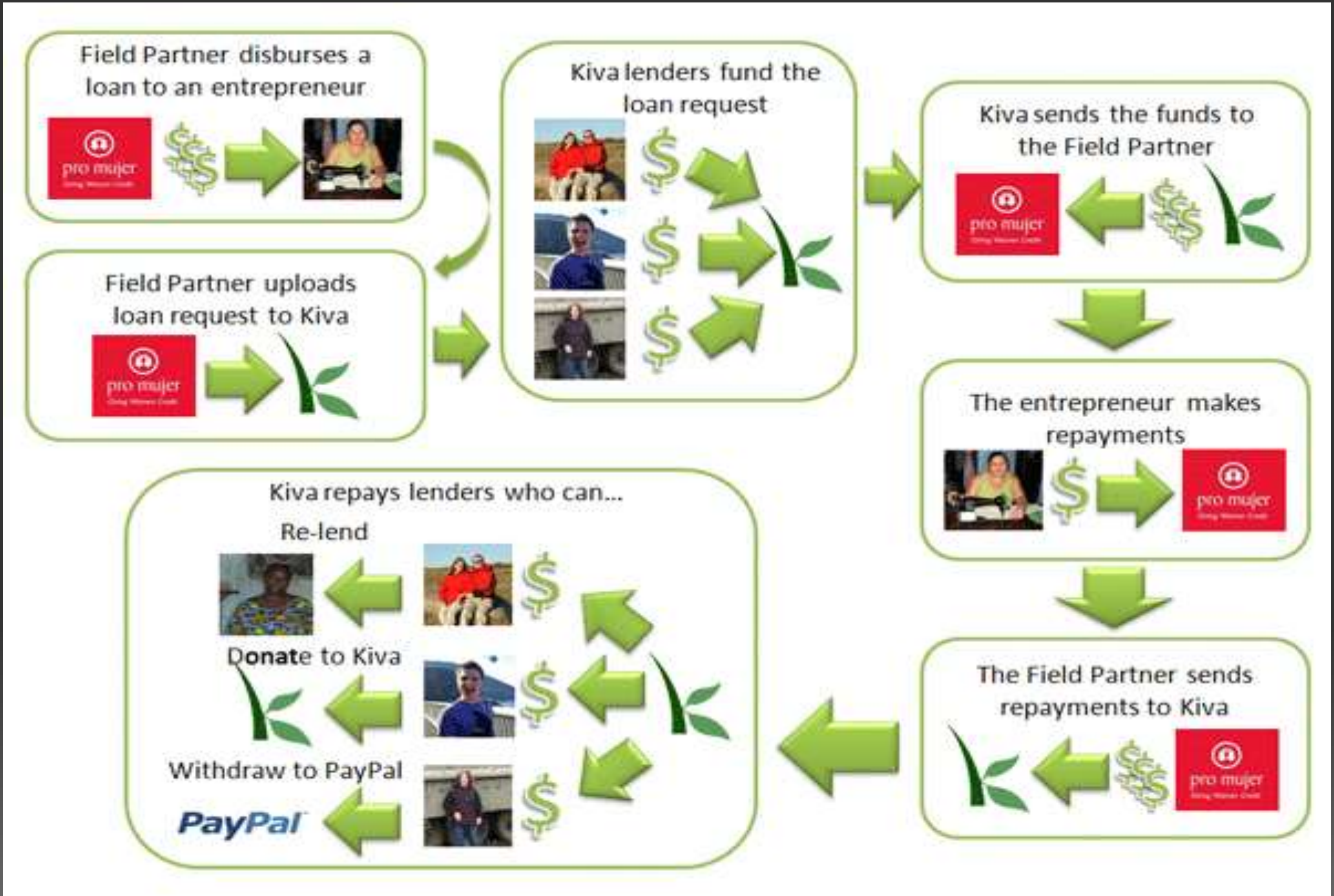
Expansion of MFIs



Mobile money

- New concept, to expand the breadth of micro-finance
- Useful in remote areas, where banking facilities do not exist
- Touted as being better for development than macro aid

Kiva



Field Partner disburses a loan to an entrepreneur
Field Partner uploads loan request to Kiva
Kiva lenders fund the loan request
Kiva sends the funds to the Field Partner
The entrepreneur makes repayments
The Field Partner sends repayments to Kiva
Kiva repays lenders who can...
Re-lend
Donate to Kiva
Withdraw to PayPal
PayPal

Retail investing vs. commercial investing

- Kiva vs. Institutions
- New twist on charity
- Highly leveraged

Grant money

- Still required to build up operational capacity
- Cover operational costs, expansion

Conclusion

- Emerging markets are doing very well right now
- Good from an investor's point of view (high returns, diversification)
- Feel-good investment
- Untapped potential

CIBIL - Credit Information Report

Agenda

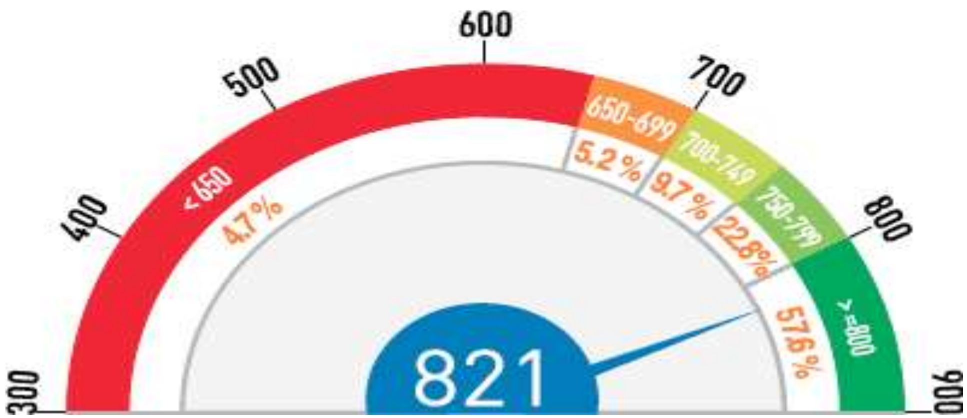
- *What is CIBIL ?*
- *CIBIL Score*
- *How It's Calculated*
- *Understand CIR Report*
- *Can you check your CIBIL score ?*
- *Facts which impact score*
- *Improve your CIBIL Score*
- *Can you correct CIR Report ?*

What is CIBIL ?

The CIBIL TransUnion Score is a 3 digit numeric summary of your credit history. The Score is derived by using the details found in the "Accounts" and "Enquiries" sections on your Credit Information Report (CIR) and ranges from 300 to 900.

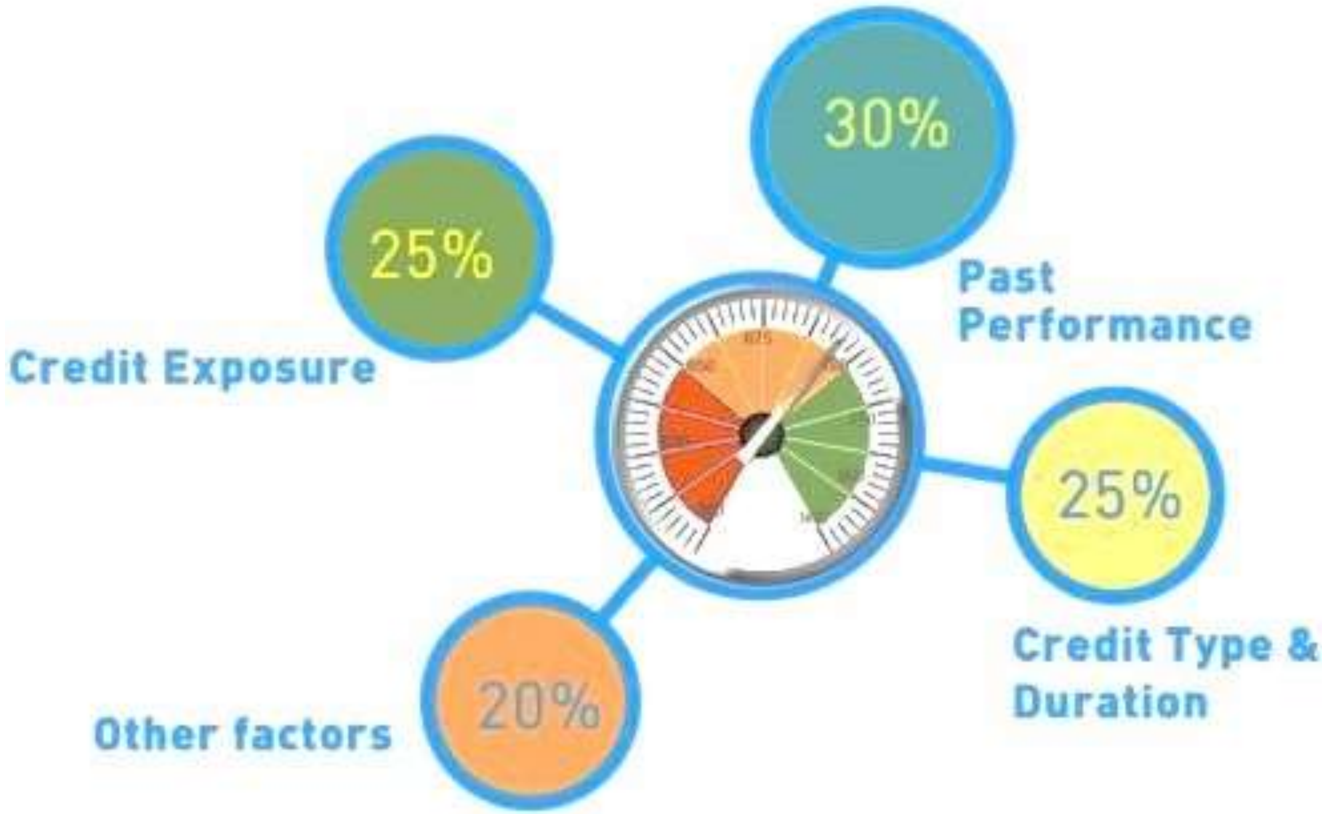
The closer your Score is to 900, the more favorably your loan application will be viewed by a credit institution. The Score plays a critical role in the loan approval process.

CIBIL Score



- A Healthy credit score >= 750
- Score is "NA" or "NH", which means No credit activity in the last couple of years or No credit exposure.

How It's Calculated



Understand CIR Report


Credit Information Bureau (India) Limited

CIBIL CONSUMER CREDIT INFORMATION REPORT

CIBIL TRANSUNION SCORE

4.7%	5.2%	9.7%	22.8%	57.6%
<550	650-699	700-749	750-799	>=800

300 — 900

Refer to the bar above to see what CIBIL TransUnion Score the banks prefer.

HOW TO IMPROVE YOUR CIBIL TRANSUNION SCORE

1. SEVERAL OVERDUE ACCOUNTS CAN BE A CONCERN TO MANY LENDERS AND CAN NEGATIVELY AFFECT YOUR CREDIT SCORE. TIMELY PAYMENTS IN THE FUTURE WILL HELP IMPROVE YOUR SCORE
2. IRREGULAR PAYMENT HISTORY MIGHT BE A RISK FACTOR TO LENDERS. TIMELY PAYMENTS IN THE FUTURE WILL CONTRIBUTE TO AN IMPROVED SCORE
3. TIMELY PAYMENTS IS A GOOD WAY TO SHOW RESPONSIBILITY TO LENDERS AND MAINTAIN A POSITIVE SCORE. MAKING CONSISTENT AND TIMELY PAYMENTS WILL IMPROVE YOUR SCORE.

PERSONAL INFORMATION

NAME	DATE OF BIRTH	GENDER
ARUN KUMAR		MALE

IDENTIFICATION TYPE	NUMBER	ISSUE DATE	EXPIRATION DATE
INCOME TAX ID NUMBER (PAN)			-
PASSPORT NUMBER	-	-	-
VOTER ID NUMBER	-	-	-
DRIVER'S LICENSE NUMBER			
RATION CARD NUMBER	-	-	-
UNIQUE ID NUMBER (UID)	-	-	-
ADDITIONAL ID #1	-	-	-

CONTACT INFORMATION

ADDRESS 1		CATEGORY	STATUS	DATE REPORTED
ADDRESS LINE 1	ADDRESS LINE 2	PERMANENT	OWNED	
ADDRESS LINE 3	ADDRESS LINE 4			
ADDRESS LINE 5				
STATE	PIN CODE			

TELEPHONE NUMBERS

TYPE	NUMBER	EXTENSION
MOBILE PHONE		
HOME PHONE		
OFFICE PHONE		
NOT CLASSIFIED		

E-MAIL CONTACT

E-MAIL ADDRESS 1

E-MAIL ADDRESS 2

E-MAIL ADDRESS 3

E-MAIL ADDRESS 4

CIBIL TransUnion Score

Personal Information, Contact & Other details received through an Enquiry

Understand CIR Report

Employment Informations

Account Informations including loan details

Enquiry Information

Can you check your CIBIL score ?

Yes, You can…

Facts which impact score

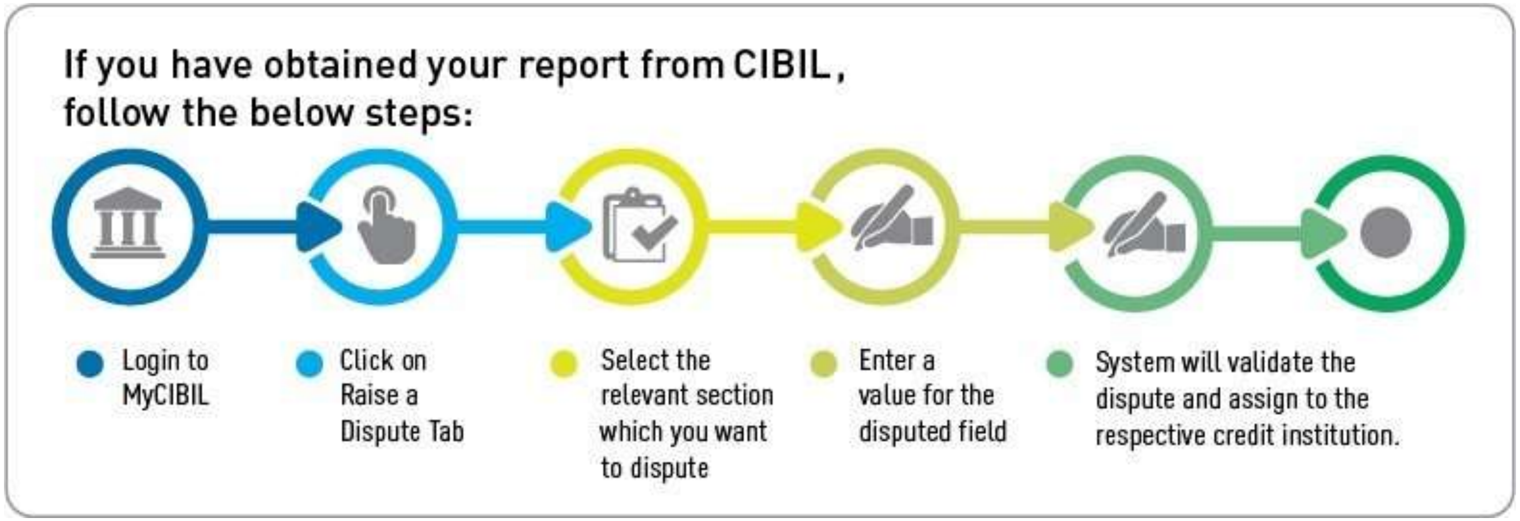
- *Higher percentage of Loans & Credit Cards*
- *Late payments or defaults in the recent past*
- *High utilization of Credit Limits*
- *Too many Unsecured Loans*
- *Seeking Excessive Credit - Credit Hunger*
- *Not tracking your credit report*

Improve your CIBIL Score

- Try to Avoid Loans & Credit Cards
- Make Payment on time, or pay at least minimum due amount.
- DONOT utilize of Full Credit Limits
- Balance Secured Vs Unsecured Loans
- Avoid Submitting unnecessary loan/credit requests
- Track your credit report periodically.

Can you correct CIR Report ?

Online Dispute Resolution Process



Thanks!

Any questions?

You can find me at:

Chandrakant.k@myspark.in

PRESENTATION ON **PRIVATE EQUITY**

What Is  Equity

- Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity.
- Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet.

Participants

- Private Equity Firm: also called LBO firm, buyout firm or financial sponsor
- Investment Banks
  - Introduce potential acquisition targets to PE firms
  - Help negotiate acquisition price
  - Provide loans or arrange bond financing
  - Arrange exit transaction
- Investors: also called Limited Partners
- Management
  - Co-invest with the PE firm: both will do very well if there is a successful exit
  - Accept lower cash compensation, but also receive options and other forms of incentive compensation

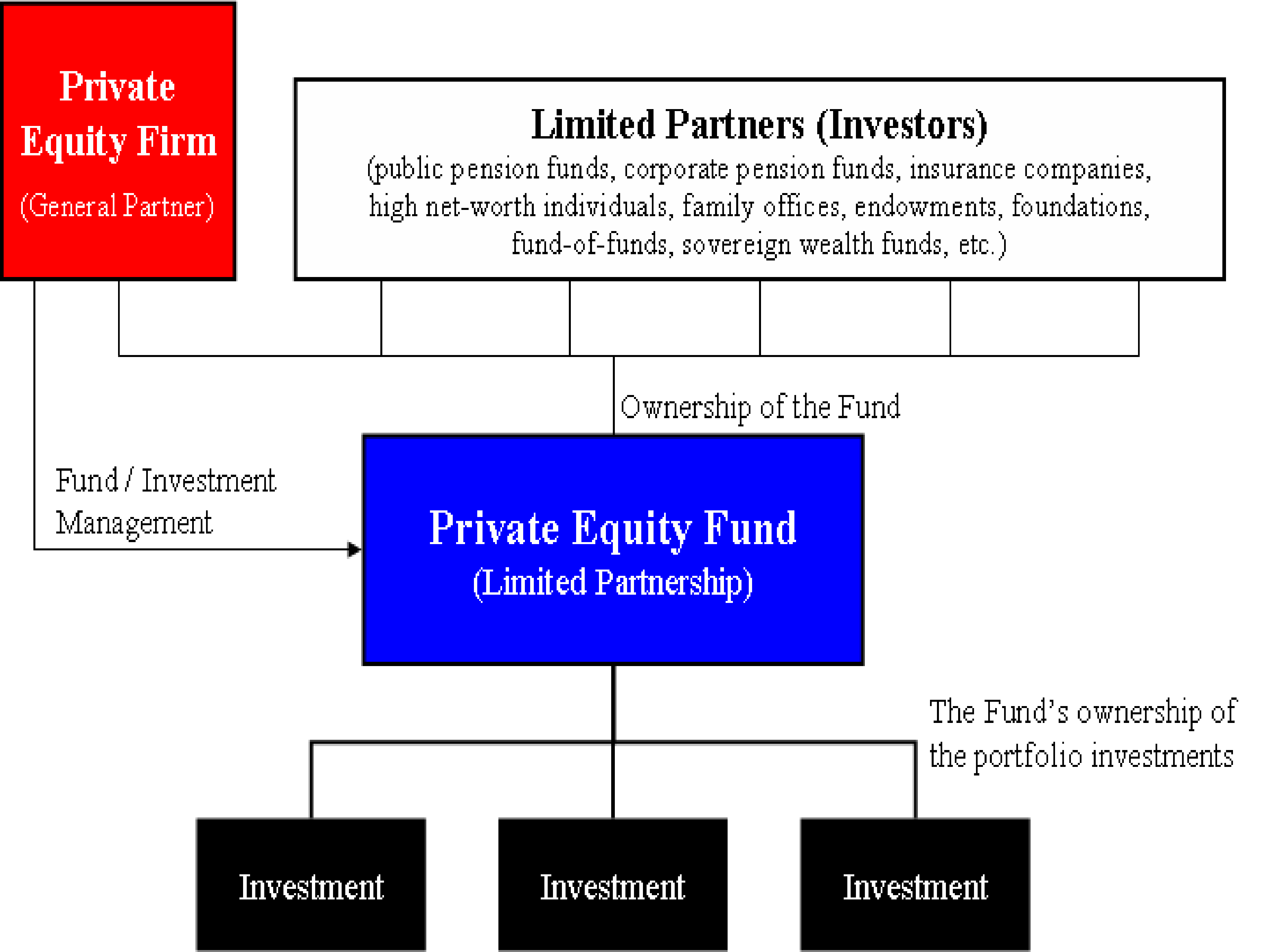
Private Equity VS. Hedge Funds

Private Equity

- Private equity investment groups are geared towards long-hold, multiple-year investment strategies in illiquid assets
- Have more control and influence over operations or asset management to influence their long-term returns

Hedge Funds

- Hedge funds usually focus on short or medium term liquid securities which are more quickly convertible to cash, and they do not have direct control over the business or asset in which they are investing.
- Have less control over the assets and lack in voting power.


Private Equity Firm
(General Partner)
Limited Partners (Investors)
(public pension funds, corporate pension funds, insurance companies, high net-worth individuals, family offices, endowments, foundations, fund-of-funds, sovereign wealth funds, etc.)
Ownership of the Fund
Fund / Investment Management
Private Equity Fund
(Limited Partnership)
The Fund's ownership of the portfolio investments
Investment
Investment
Investment

Fund of Funds

- A private equity fund of funds consolidates investments from many individual and institutional investors to make investments in a number of different private equity funds
- This enables investors to access certain private equity fund managers that they otherwise may not be able to invest with, diversifies their private equity investment portfolio and augments their due diligence process in an effort to invest in high quality funds that have a high probability of achieving their investment objectives
- Private equity fund of funds represent about 15% of committed capital in the private equity market

Types Of Private Equity

- Private equity can be broadly defined to include the following different forms of investment:

  - **Leveraged Buyout:** Leveraged buyout (LBO) refers to the purchase of all or most of a company or a business unit by using equity from a small group of investors in combination with a significant amount of debt.
  - The targets of LBOs are typically mature companies that generate strong operating cash flows. Private equity firms view target companies :-

1. Platform companies
2. add-on or tuck-in acquisitions

- **Growth Capital :-** refers to equity investments, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.
- Because of lack of scale these companies generally have a few alternative conduits to secure capital for growth.
- The primary owner of the company may not be willing to take the financial risk alone.

Mezzanine capital

- Mezzanine capital refers to subordinated debt or preferred equity securities that often represent the most junior portion of a company's capital structure that is senior to the company's common equity.
- This form of financing is often used by private equity investors to reduce the amount of equity capital required to finance a leveraged buyout or major expansion.
- Mezzanine capital, which is often used by smaller companies that are unable to access the high yield market, allows such companies to borrow additional capital beyond the levels that traditional lenders are willing to provide through bank loans.

Venture capital

- Venture capital is a broad subcategory of private equity that refers to equity investments made, typically in less mature companies, for the launch of a seed or start-up company, early stage development, or expansion of a business.
- Venture investment is most often found in the application of new technology, new marketing concepts.
- Many entrepreneurs do not have sufficient funds to finance projects themselves, and they must therefore seek outside financing.
- Venture capital is most suitable for businesses with large up-front capital requirements which cannot be financed by cheaper alternatives such as **debt**.

History And Development

- The seeds of the US private equity industry were planted in 1946 with the founding of two venture capital firms: American Research and Development Corporation (ARDC) and J.H. Whitney & Company.
- Before World War II, venture capital investments (originally known as "development capital") were primarily the domain of wealthy individuals and families. In 1901 J.P. Morgan arguably managed the first leveraged buyout of the Carnegie Steel Company using private equity.
- Modern era private equity, however, is credited to Georges Doriot, the "father of venture capitalism" with the founding of **ARDC** and founder of **INSEAD**, with capital raised from institutional investors, to encourage private sector investments in businesses run by soldiers who were returning from World War II.

Origins of the leveraged buyout

- The first leveraged buyout may have been the purchase by McLean Industries, Inc. of Pan-Atlantic Steamship Company in January 1955 and Waterman Steamship Corporation in May 1955·Under the terms of that transaction, McLean borrowed $42 million and raised an additional $7 million through an issue of preferred stock.
- When the deal closed, $20 million of Waterman cash and assets were used to retire $20 million of the loan debt.
- Similar to the approach employed in the McLean transaction, the use of publicly traded holding companies as investment vehicles to acquire portfolios of investments in corporate assets was a relatively new trend in the 1960s popularized by the likes of **Warren Buffett (Berkshire Hathaway)** and later adopted by **Nelson Peltz (Triarc**), **Saul Steinberg (Reliance Insurance)** and **Gerry Schwartz**.

Role And Importance Of private Equity

- They help in growth of the Economy
- Helps the companies for expanding to international markets
- Life Boat for the companies who have unfortunately come under hard times and need a turnaround
- Expertise to lead them on a new and sustainable path.
- Greater expansion of business create more employment.

Private equity fund performance

- Due to limited disclosure, studying the returns to private equity is relatively difficult, unlike Mutual funds.
- It is challenging to compare private equity performance to public equity performance, in particular because private equity fund investments are drawn and returned over time as investments are made and subsequently realized
- It is also claimed that PE fund managers manipulate data to present themselves as strong performers, which makes it even more essential to standardize the industry
- The application of the Freedom of Information Act (FOIA) in U.S. and Guidelines for Disclosure and Transparency in Private Equity in U.K , now makes data readily available.

Returns On Private Equity Investments

- Returns on private equity investments are created through one or a combination of three factors that include:

1. debt repayment or cash accumulation through cash flows from operations
2. operational improvements that increase earnings over the life of the investment and multiple expansion
3. selling the business for a higher multiple of earnings than was originally paid

Ways To Exit A Company

- *Initial Public Offering (IPO)* – shares of the company are offered to the public, typically providing a partial immediate realization to the financial sponsor as well as a public market into which it can later sell additional shares;
- *Merger or Acquisition* – the company is sold for either cash or shares in another company;
- *Recapitalization* – cash is distributed to the shareholders (in this case the financial sponsor) and its private equity funds either from cash flow generated by the company or through raising debt or other securities to fund the distribution.

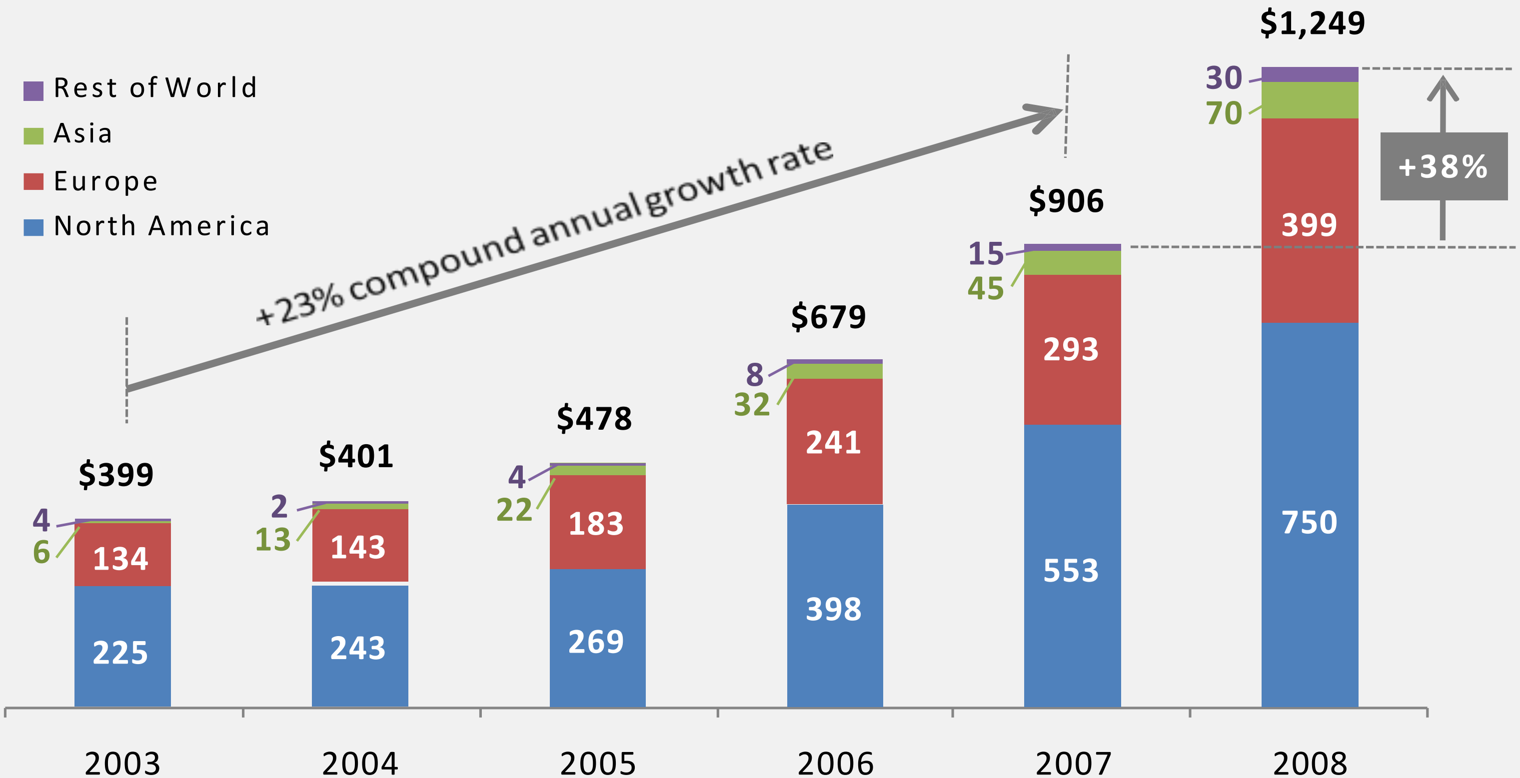
Size of the industry

- The state of the industry around the end of 2011 was as follows:-
- Private equity assets under management probably exceeded $2.0 trillion at the end of March 2012, and funds available for investment totaled $949bn.
- Some $246bn of private equity was invested globally in 2011, down 6% on the previous year and around two-thirds below the peak activity in 2006 and 2007.
- Following on from a strong start, deal activity slowed in the second half of 2011 due to concerns over the global economy and sovereign debt crisis in Europe.
- The fund raising environment remained stable for the third year running in 2011 with $270bn in new funds raised, slightly down on the previous year's total. Around $130bn in funds was raised in the first half of 2012, down around a fifth on the first half of 2011

Assets Under Management (AUM)

Private Equity Assets Under Management Reached $1.2 Trillion in 2008

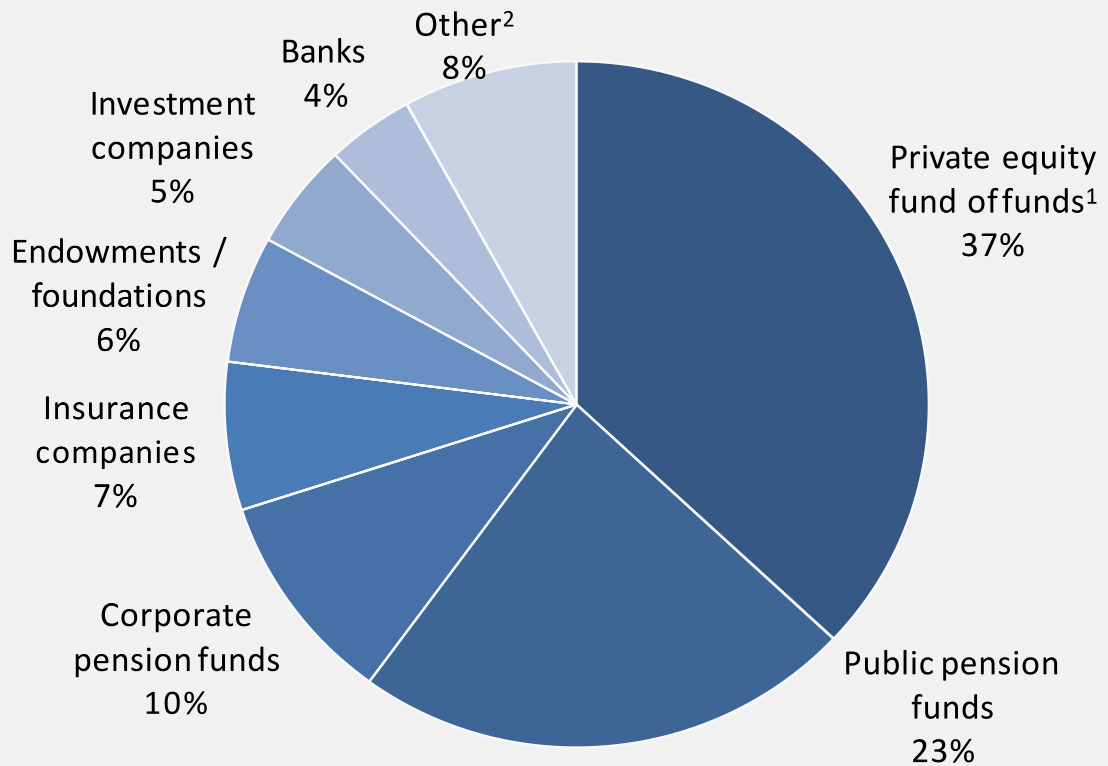
Leveraged buyout assets under management [1], 2003 – 2008, $ in billions



Note 1: Assets under management defined as sum of funds raised in the current year plus the previous four years.
Source: McKinsey Global Institute; Preqin

Assets Under Management (AUM)

2005 Global Allocations to Private Equity LBO Funds by Type of Limited Partner



Note 1: Assets come from pensions, other institutions, and wealthy individuals.
Note 2: Includes wealthy individuals.
Source: McKinsey Global Institute; Preqin

KKR

The Blackstone Group

The Carlyle Group

Texas Pacific Group

BainCapital

CVC Capital Partners

Warburg Pincus

Apax Partners

TerraFIRMA Capital Partners

Advent International Global Private Equity

Permira

KPCB Kleiner Perkins Caufield & Byers

candover

Macquarie

intel

Goldman Sachs

3i The world is yours

JPMorgan

Ontario Teachers' Pension Plan

Cerberus Capital Management, L.P.

Private equity firms

- According to an updated 2013 ranking created by industry magazine Private Equity International, based on the amount of private equity direct-investment capital raised over a five-year window :-
- 10.
- Headquarters London, United Kingdom Luxembourg City

09.

Bain Capital
PRIVATE EQUITY

Headquarters:-200 Clarendon Street
Boston, Massachusetts, U.S.

- 08. APOLLO

  GLOBAL MANAGEMENT

- Headquarters Solow Building New York City, United States

07.

Advent International

GLOBAL PRIVATE EQUITY

Headquarters :- Boston, Massachusetts, United States

- 06. 

- Headquarters85 Broad Street
  New York City, New York, United States

- 05.
- Headquarters450 Lexington Avenue
  New York City, New York, United States

- 04

KKR

KOHLBERG KRAVIS ROBERTS & CO.

Headquarters :-9 West 57th Street Suite 4200
New York, New York 10019
U.S.

03.

Headquarters :-345 Park Avenue
Manhattan, New York City, USA

02.

Headquarters :-Washington, DC, U.S.

- 01.

- Headquarters :- Fort Worth, Texas
  San Francisco, California, U.S.

TOP 10 Biggest Private Equity Buyouts in History

- #10 Alliance Boots
- **Deal value in 2007:** $24.8 billion
- **Inflation adjusted value:** $26.4 billion
- **Buyers:** KKR
- The British pharmacy and healthcare chain is the largest leveraged buyout in the history of European business.

#9 Hilton Hotels

- **Deal value in 2007:** $26 billion
- **Inflation adjusted value:** $27.68 billion
- **Buyers:** Blackstone
- Blackstone took control of Conrad Hilton's resort and hotel empire by spending billions and moving fast to take the company private towards the end of 2007

#8 Clear Channel

- **Deal value in 2006:** $25.7 billion
- **Inflation adjusted value:** $28.14 billion
- **Buyers:** KKR, Bain Capital and Thomas H. Lee
- Buying out Clear Channel communications gave the three firms involved in the deal access to what was a compellingly emergent satellite radio market in 2006.

#7 Alltel

- **Deal value in 2007:** $27 billion
- **Inflation adjusted value:** $28.74 billion
- **Buyers:** Goldman Sachs and TPG Capital
- After picking up Alltel for a rather hefty sum in 2007, Goldman and TPG turned around and sold the wireless company to Verizon for a profit of almost $3 billion, less than a year later.

#6 Harrah's Entertainment

- **Deal value in 2006:** $27.4 billion
- **Inflation adjusted value:** $30 billion
- **Buyers:** Apollo Global Management and TPG
- After the gaming conglomerate acquired the Caesar's Entertainment corporation in 2005, shares jumped, but that didn't deter Apollo and TPG from forming Hamlet Holdings and taking Harrah's private in 2008.

#5 First Data

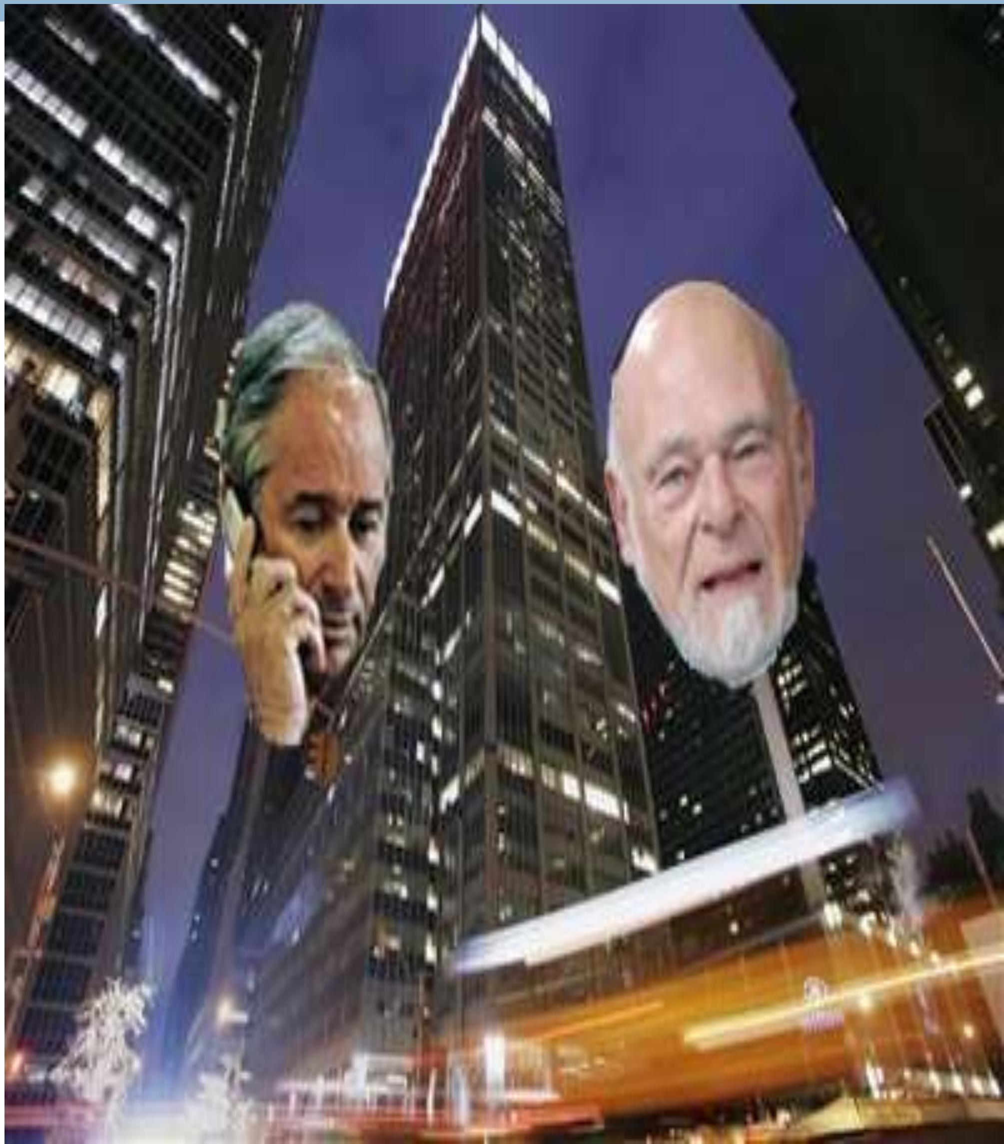
- **Deal value in 2007:** $29 billion
- **Inflation adjusted value:** $30.87 billion
- **Buyers:** KKR and TPG
- The 2007 KKR-led buyout of internet commerce giant First Data took over the title of the largest technology deal in the history of private equity. A title it still holds.

#4 Hospital Corp. of America

- **Deal value in 2006:** $32.7 billion
- **Inflation adjusted value:** $35.81 billion
- **Buyers:** Bain, KKR and Merrill Lynch
- At the time (and without being adjusted for inflation), the 2006 buyout of HCA was the largest private equity deal in history.

#3 Equity Office Properties

- **Deal value in 2007:** $38.9 billion
- **Inflation adjusted value:** $41.41 billion
- **Buyers:** Blackstone
- This deal was a veritable "Clash of the Titans" between Sam Zell and Steve Schwarzman.
- Well, if by "Clash" one means "Everybody gets wealthier."

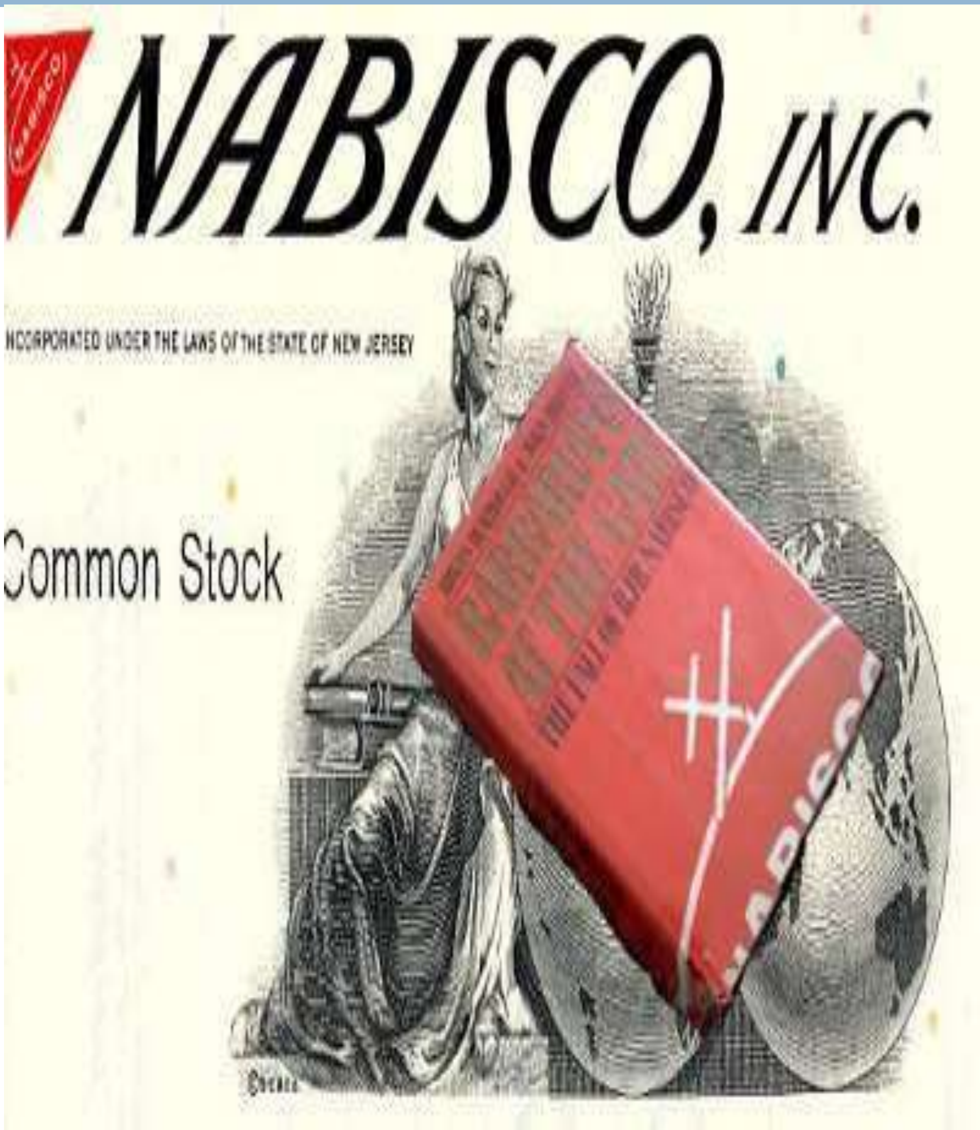


#2 Energy Future Holdings

- **Deal value in 2007:** $44.37 billion
- **Inflation adjusted value:** $47.23 billion
- **Buyers:** KKR, TPG and Goldman Sachs
- As if they felt challenged by Blackstone's enormous deal to acquire Equity Office, KKR, Goldman and TPG moved fast to spend $45 billion on the massive Dallas-based electric utility company and then appoint former Secretary of State to run the whole thing.

#1 RJR Nabisco

- **Deal value in 1989:** $31.1 billion
- **Inflation adjusted value:** $55.38 billion
- **Buyers:** KKR
- Still the biggest, badest and most iconic private equity buyout of all time, KKR's staggeringly aggressive (and inevitably contentious) move on the tobacco and food titan can be fairly credited with giving rise to the leveraged buyout boom over the next twenty-odd years.



Top 10 Private Equity Firms In India

1. ICICI Venture
2. Chrys Capital
3. Sequoia Capital
4. India Value Fund
5. Kotak Private Equity Group
6. Baring Private Equity Partners
7. Ascent Capital
8. CX Partners
9. Everstone Capital
10. Blackstone Group

Questions for discussion:

- 1.Does private equity ownership provide a better form of governance and incentives?
- 2. Should policy makers be worried about the practices of PE houses?


THANK YOU