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Department of Master of Business Administration

E-Content File

II MBA III Semester

Subject

FINANCIAL INSTITUTIONS MARKETS AND SERVICES

Code: C1E21

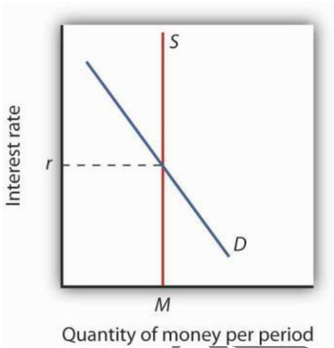
Academic Year 2023-24

Regulations: MR22

MODULE – 1

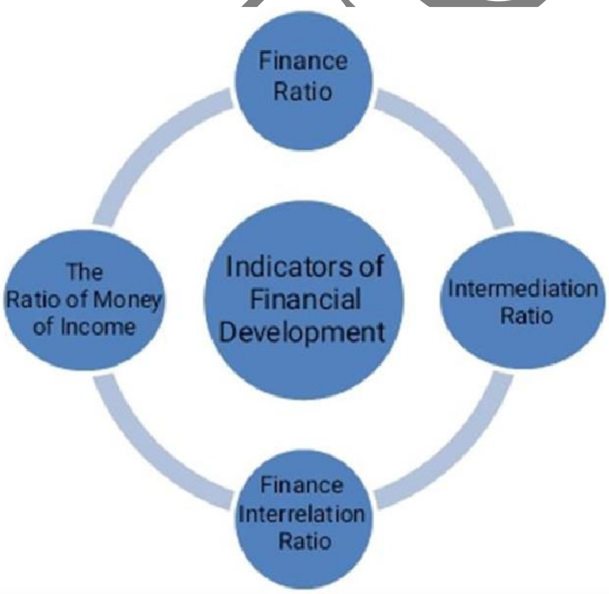
Equilibrium in Financial markets:

The **money market** is the interaction among institutions through which money is supplied to individuals, firms, and other institutions that demand money. **Financial market equilibrium** occurs at the interest rate at which the quantity of money demanded is equal to the quantity of money supplied. "Money Market Equilibrium" combines demand and supply curves for money to illustrate equilibrium in the market for money. With a stock of money (M), the equilibrium interest rate is r.



The market for money is in equilibrium if the quantity of money demanded is equal to the quantity of money supplied. Here, equilibrium occurs at interest rate r.

Indicators of Financial Development:



1. **Finance Ratio:** The ratio of total issues of primary and secondary claim to national income.
2. **Intermediation ratio:** The ratio of secondary issue to primary issue, which indicates the extent of development of financial institutions as mobilizers of funds relative to real sectors as direct mobilizers of funds. It indicates institutionalization of financial activity in the economy.
3. **The Ratio of Money to Income:** Higher the ratio greater the financial development because it indicates the extent of monetization and size of the exchange economy in the nation. Developed Financial sector is fully integrated domestically as well as internationally. In such a system risk adjusted rate of return doesn't differ significantly in respect of investor as well as saver. The lower the transaction and information cost, the higher the financial development.
4. **Finance Interrelation Ratio:** The ratio of financial assets to physical assets in the economy.

Financial System and Economic development: The development of any country depends on the economic growth the country achieves over a period of time. Economic growth deals with investment and production and also the extent of Gross Domestic Product in a country.

The following are the roles of financial system in the economic development of a country:-

1. Savings-investment relationship: To attain economic development, a country needs more investment and production. This can happen only when there is a facility for savings. As such savings are channelized to productive resources in the form of investment. Here, the role of financial institutions is important, since they induce the public to save by offering attractive interest rates. These savings are channelized by lending to various business concerns which are involved in production and distribution.

2. Financial systems help in growth of the capital market: Any business requires two types of capital namely, fixed capital and working capital. Fixed capital is used for investment in fixed assets, like plants and machinery. While working capital is used for the day-to-day running of business. It is also used for purchase of raw materials and converting them into finished products.

- **Fixed capital** is raised through capital market by the issue of debentures and shares. Public and other financial institutions invest in them in order to get a good return with minimized risks.

- For **working capital**, we have money market, where short-term loans could be raised by the businessmen through the issue of various credit instruments such as bills, promissory notes, etc.

- Foreign exchange market enables exporters and importers to receive and raise funds for settling transactions. It also enables banks to borrow from and lend to different types of customers in various foreign currencies.

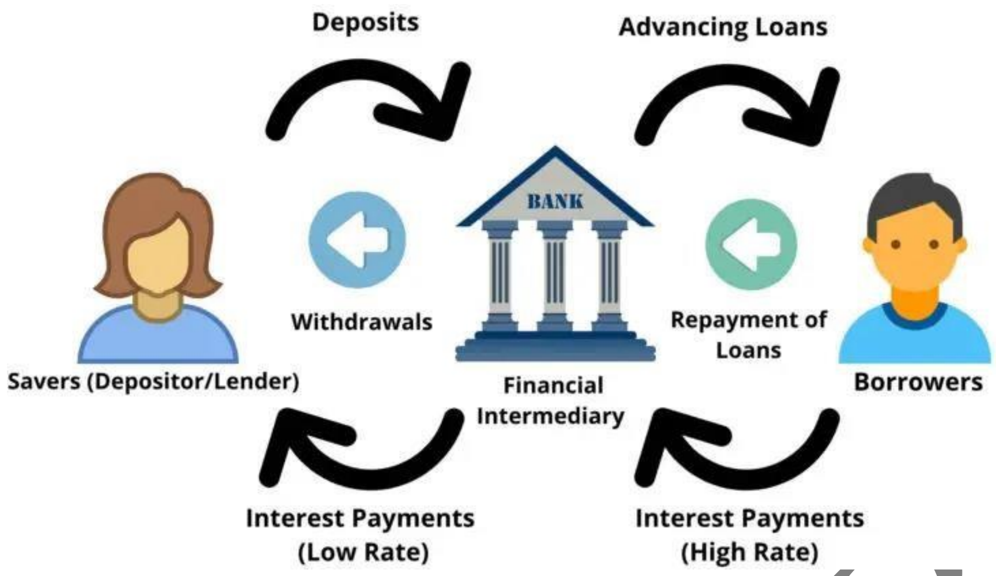
3. Government Securities market: Financial system enables the state and central governments to raise both short-term and long-term funds through the issue of bills and bonds which carry attractive rates of interest along with tax concessions. The budgetary gap is filled only with the help of the government securities market. Thus, the capital market, money market along with foreign exchange market and government securities market enable businessmen, industrialists as well as governments to meet their credit requirements. In this way, the development of the economy is ensured by the financial system.

4. Financial system helps in Infrastructure and Growth: Economic development of any country depends on the infrastructure facility available in the country. In the absence of key industries like coal, power and oil, development of other industries will be hampered. It is here that the financial services play a crucial role by providing funds for the growth of infrastructure industries. Private sector will find it difficult to raise the huge capital needed for setting up infrastructure industries.

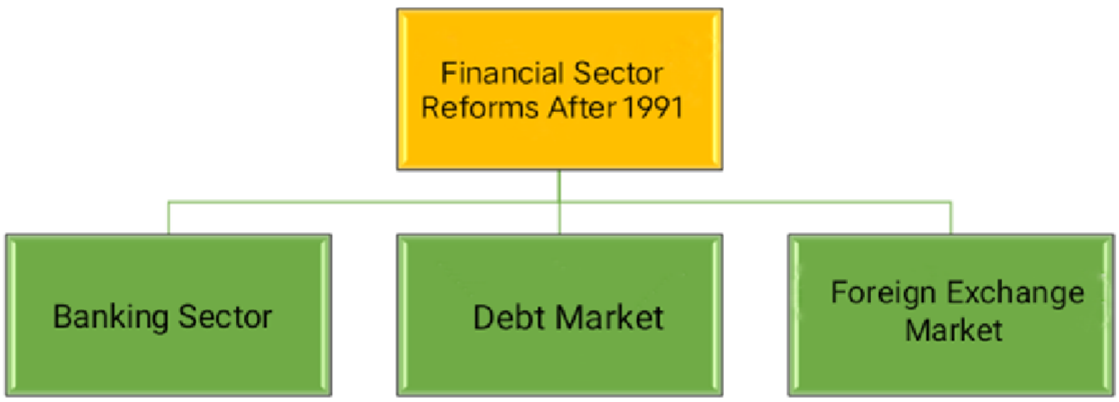
5. Financial system helps in development of Trade: The financial system helps in the promotion of both domestic and foreign trade. The financial institutions finance traders and the financial market helps in discounting financial instruments such as bills. Foreign trade is promoted due to per-shipment and post-shipment finance by commercial banks. They also issue Letter of Credit in favor of the importer. Thus, the precious foreign exchange is earned by the country because of the presence of the financial system.

6. Employment Growth is boosted by the financial system: The presence of a financial system will generate more employment opportunities in the country. The money market which is a part of the financial system provides working capital to the businessmen and manufacturers due to which production increases, resulting in generating more employment opportunities. With competition picking up in various sectors, the service sector such as sales, marketing, advertisement, etc., also picks up, leading to more employment opportunities. Various financial services such as leasing, factoring, merchant banking, etc., will also generate more employment. The growth of trade in the country also induces employment opportunities.

7. Venture Capital: There are various reasons for lack of growth of venture capital companies in India. The economic development of a country will be rapid when more ventures are promoted which require modern technology and venture capital. Venture capital cannot be provided by individual companies as it involves more risks. It is only through the financial system, more financial institutions will contribute a part of their investable funds for the promotion of new ventures. Thus, the financial system enables the creation of venture capital.



Financial sector reforms after 1991



Reforms in the Banking Sector

- Reduction in CRR and SLR has given banks more financial resources for lending to the agriculture, industry and other sectors of the economy.
- The system of administered interest rate structure has been done away with and RBI no longer decides interest rates on deposits paid by the banks.
- Allowing domestic and international private sector banks to open branches in India. For example, HDFC Bank, ICICI Bank, Bank of America, Citibank, American Express, etc.
- Issues pertaining to non-performing assets were resolved through Lok adalats, civil courts, Tribunals, The Securitisation and Reconstruction of Financial Assets and the Enforcement of Security Interest (SARFAESI) Act.

- The system of selective credit control that had increased the dominance of RBI was removed so that banks can provide greater freedom in giving credit to their customers.

Reforms in the Debt Market:

- The 1997 policy of the government that included **automatic monetization of the fiscal deficit** was removed resulting in the government borrowing money from the market through the auction of government securities.
- **Borrowing by the government** occurs at market-determined interest rates which have made the government cautious about its fiscal deficits.
- Introduction of **treasury bills by the government for 91 days** for ensuring liquidity and meeting short-term financial needs and for benchmarking.
- To ensure transparency the government introduced a s**ystem of delivery versus payment settlement.**

Reforms in the Foreign Exchange Market:

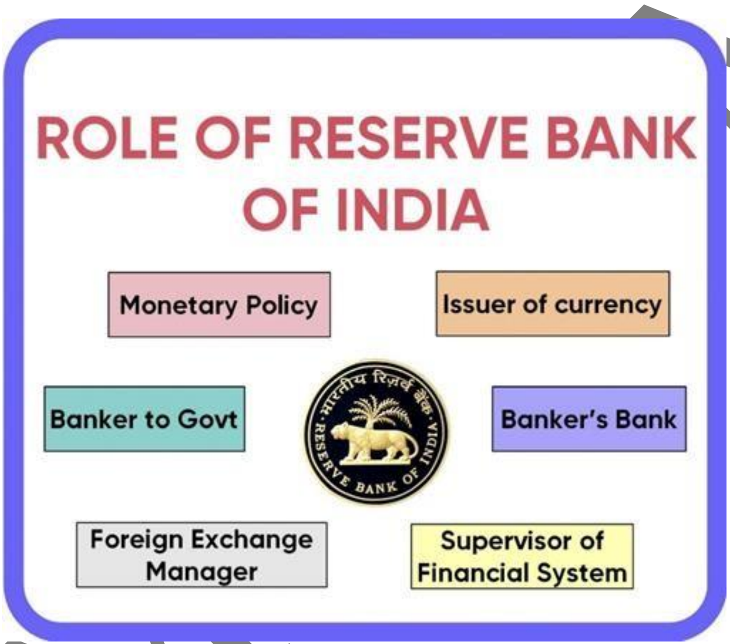
- **Market-based exchange rates and the current account convertibility** were adopted in 1993.
- The government permitted **the commercial banks to undertake operations in foreign exchange**.
- Participation of newer players allowed in **rupee foreign currency swap market** to undertake currency swap transactions subject to certain limitations.
- **Replacement of foreign exchange regulation act (FERA), 1973** was replaced by the **foreign exchange management act (FEMA), 1999** for providing greater freedom to the exchange markets.
- **Trading in exchange-traded derivatives** contracts was permitted for foreign institutional investors and non-resident Indians subject to certain regulations and limitations.

Functions and Role of RBI:

The Reserve Bank of India is the backbone of the Financial System of the country. It has been entrusted by the people and the Government to control, supervise and promote the flow of money in the market. It also takes part in planning and development to maintain economic stability of the country and take the country towards growth.

Reserve Bank of India was established in 1935 and since then it has regulated the flow of Indian rupee in the country. The Reserve Bank is also responsible for managing other commercial banks through its various policies and directions.

Every bank is entitled to keep an amount of money with the RBI which serves as the limit to the amount of money that bank can lend to the public.



<u>Functions of RBI:</u>

According to the RBI act 1934 RBI has various functions to serve. Some of them include:

1. **Monetary Authority:** It plans and supervises the monetary policies designed for the country. The objective behind this is that every policy should be designed keeping in mind the idea of growth and at the same time should also maintain price stability.
2. **Financial System Supervisor:** It designs the parameters under which all the banks of the country should work. The main aim here is to maintain the trust of the general public in the financial system of the country and provide them services which are cost-friendly.

3. **Foreign Exchange:** All the foreign exchange that happens between the countries is maintained and looked after by RBI. This is done so that easy and smooth foreign trade can happen and also foreign market remains maintained.
4. **Issuer of currency:** RBI is the authority who issues notes, destroys the old notes and decides which currency is fit for circulation among the people. Demonetisation was done after taking advice from RBI and the new notes of 2000 came into circulation.
5. **Development:** various national projects are funded by RBI. It undertakes development of the country as its objective and invests at various places in national interest.

RBI also has certain supervisory functions to fulfil. They include

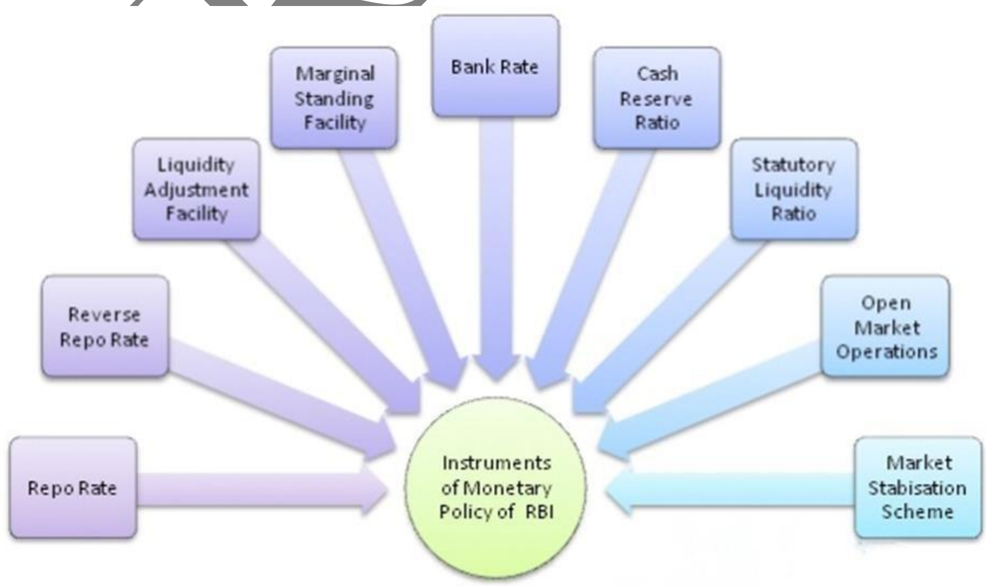
- Granting licence to commercial banks
- Inspection of the other banks
- Implementing Deposit Insurance scheme
- Controlling Non-Banking financial institutions

Monetary Policy and techniques of monetary control of RBI

The primary goal of monetary policy of RBI is to maintain price stability keeping in mind the objectives laid out in the economic plan. Price stability is extremely important for attaining sustainable growth. To maintain price stability, inflation must be kept in check. RBI uses various monetary policy instruments to ensure that inflation is controlled.

Monetary Policy Instruments:

There are several direct and indirect monetary policy instruments that help in implementing the monetary policy in India. They are as follows:



- **Repo Rate:** Repo rate is the rate at which RBI lends short term loans (less than 90 days) to commercial banks.

- **Reverse Repo Rate:** Reverse repo is the rate at which the RBI keeps the extra deposit of all banks within itself.

- **Marginal Standing Facility (MSF):** It is the rate at which banks borrow overnight loans from RBI. It can be only up to 2% of the NTDL (Net Demand and Time Liabilities). It is always 1% or 100 basis points more than the repo rate.

- **Bank Rate:** It is the rate at which RBI offers long term loans (more than 90 days) to commercial banks.

- **Cash Reserve Ratio (CRR):** It is the ratio of the bank's total deposit that every bank has to keep with the RBI. It has to be in cash form only. RBI does not offer any interest on this reserve money. It can be between 0 to 15%. RBI announces the CRR in its monetary policy.

- **Statutory Liquidity Ratio (SLR):** It is the ratio of the bank's total deposit that a bank has to maintain with itself. It can either be in cash or in liquid assets including Gold, Foreign Currency, Government Bonds, etc. It can be between 0 to 40% as announced by the RBI in its monetary policy.

- **Open Market Operations (OMO):** It refers to the buying and selling of government securities between the RBI & banks.

Role and Functions of SEBI:

Role of SEBI:

This regulatory authority acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment for the financial market enthusiasts that facilitate the efficient and smooth working of the securities market. SEBI also plays an important role in the economy. To make this happen, it ensures that the three main participants of the financial market are taken care of, i.e. issuers of securities, investors, and financial intermediaries.

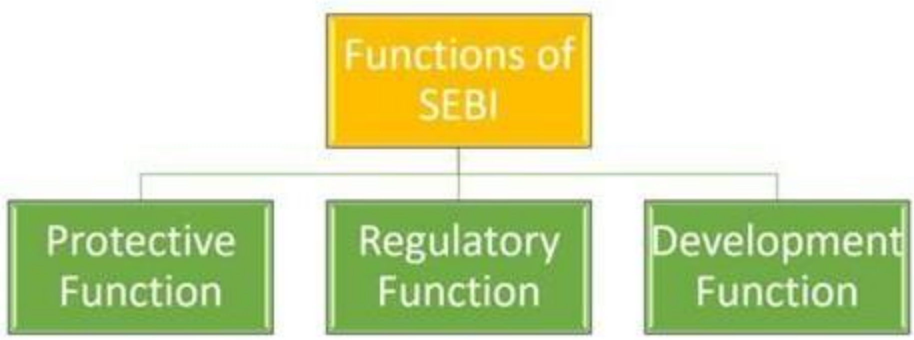
1. <u>Issuers of securities:</u> These are entities in the corporate field that raise funds from various sources in the market. This organization makes sure that they get a healthy and transparent environment for their needs.

2. <u>Investor:</u> Investors are the ones who keep the markets active. This regulatory authority is responsible for maintaining an environment that is free from malpractices to restore the confidence of the general public who invest their hard-earned money in the markets.

3. <u>Financial Intermediaries:</u> These are the people who act as middlemen between the issuers and investors. They make the financial transactions smooth and safe.

<u>Functions of SEBI:</u>

The main primary three functions are-



1. Protective Function
2. Regulatory Function
3. Development Function

1. <u>Protective Functions</u>: As the name suggests, these functions are performed by SEBI to protect the interest of investors and other financial participants.

It includes-

- Checking price rigging
- Prevent insider trading
- Promote fair practices
- Create awareness among investors
- Prohibit fraudulent and unfair trade practices

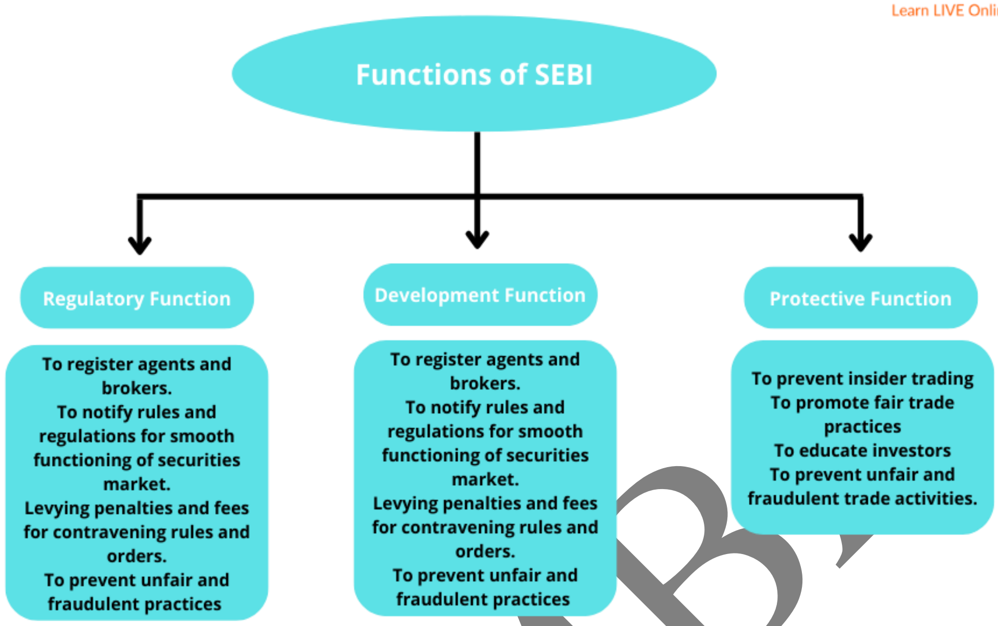
2. Regulatory Functions: These functions are basically performed to keep a check on the functioning of the business in the financial markets.

These functions include-

- Designing guidelines and code of conduct for the proper functioning of financial intermediaries and corporate.
- Regulation of takeover of companies
- Conducting inquiries and audit of exchanges
- Registration of brokers, sub-brokers, merchant bankers, etc.
- Levying of fees
- Performing and exercising powers
- Register and regulate credit rating agency

3. Development Functions: This regulatory authority performs certain development functions also that include but they are not limited to-

- Imparting training to intermediaries
- Promotion of fair trading and reduction of malpractices
- Carry out research work
- Encouraging self-regulating organizations
- Buy-sell mutual funds directly from AMC through a broker.

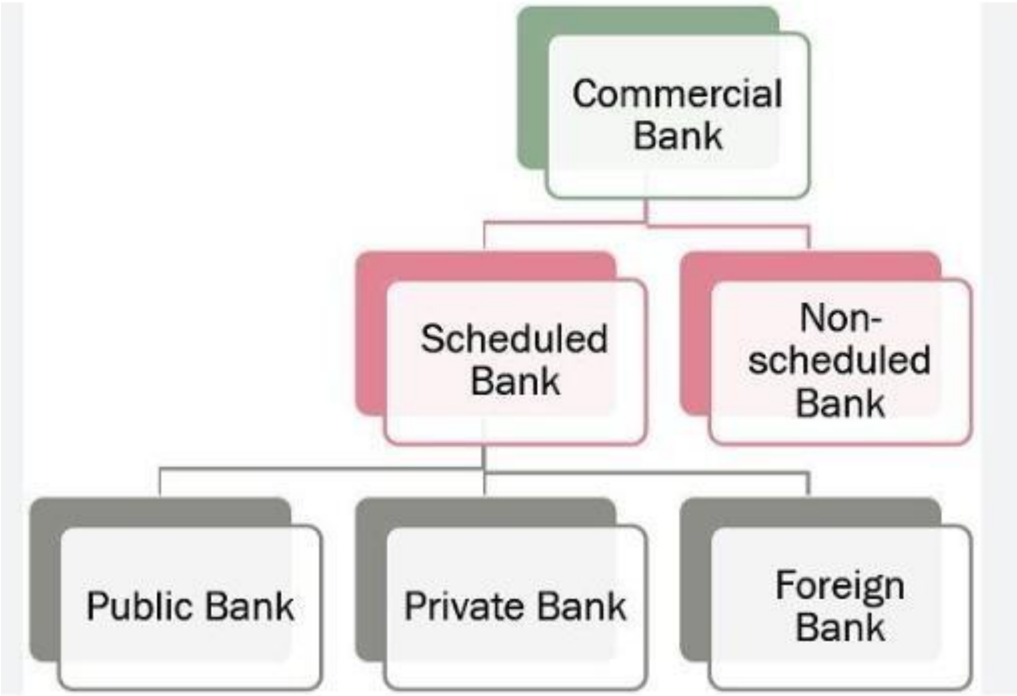


MODULE- 2

Commercial Bank:

A commercial bank is a financial institution that provides services like loans, certificates of deposits, savings bank accounts, bank overdrafts, etc. to its customers. These institutions make money by lending loans to individuals and earning interest on loans. Various types of loans given by a commercial bank are business loans, car loans, house loans, personal loans, and education loans.

They give out these loans from the money deposited by their customers in different types of accounts. They use the deposits as capital for providing loans. Commercial banks are essential for the economy of a country because they help in creating capital, credit as well as liquidity in the market. These banks are generally physically located in cities but these days online banks are growing in numbers.



Commercial banks working:

Commercial banks offer basic services of banking to the public including individual customers as well as small and medium-sized businesses. Money is made by banks by charging for services and fees. The fees depend on the products given such as overdraft fees, fees for safe deposit boxes, late fees, etc.

Various loans also consist of fees other than interest on loans. Banks earn money by giving out loans and for that purpose they use funds from customer deposits. They charge higher interest rates on loans they give out and comparatively less rate of interest on the amount they get as deposits from their customers. For e.g A bank may provide a 0.30 per cent rate of interest on savings accounts to its customers but charge a 4.8 per cent rate of interest annually for home loans.

Commercial Banks can be further classified into public sector banks, private sector banks, foreign banks and Regional Rural Banks (RRB). On the other hand, cooperative banks are classified into urban and rural.

Public sector banks:

These are the nationalised banks and account for more than 75 percent of the total banking business in the country. Majority of stakes in these banks are held by the government. In terms of volume, SBI is the largest public sector bank in India and after its merger with its 5 associate banks (as on 1st April 2017) it has got a position among the top 50 banks of the world.

There are 12 public sector banks in India currently

- Bank of Baroda
- State Bank of India
- Punjab National Bank
- Bank of Baroda
- Canara Bank
- Union Bank of India
- Bank of India
- Indian Bank
- Central Bank of India
- Indian Overseas Bank
- UCO Bank
- Bank of Maharashtra
- Punjab & Sindh Bank

Private sector banks:

These include banks in which major stake or equity is held by private shareholders. All the banking rules and regulations laid down by the RBI will be applicable on private sector banks as well. In India, private sector banks are classified into two divisions

1. Old Private sector banks (these banks emerged before 1968)
2. New Private sector banks (these banks emerged after the 1990s).

Given below is the list of private-sector banks in India-

- Axis Bank
- Bandhan Bank
- CSB Bank
- City Union Bank
- DCB Bank
- HDFC Bank Etc

Cooperative banking:

Cooperative banking is retail and commercial banking organized on a cooperative basis. Cooperative banking institutions take deposits and lend money in most parts of the world.

Cooperative banking, as discussed here, includes retail banking carried out by credit unions, mutual savings banks, building societies and cooperatives, as well as commercial banking services provided by mutual organizations (such as cooperative federations) to cooperative businesses.

UTI – Unit Trust of India:

A unit trust is an investment plan in which the funds are pooled together and then invested. The fund which is pooled is then unitized and the investor who is one party to the unit trust is called a unit holder, holding a certain number of units.

A second party i.e. the manager is responsible for the day-to-day running of the trust and for investing the funds. The trustee, governed by the Trust Companies Act 1967, is the third party, and their role is to monitor the manager's performance against the trust's deed.

Functions of UTI:

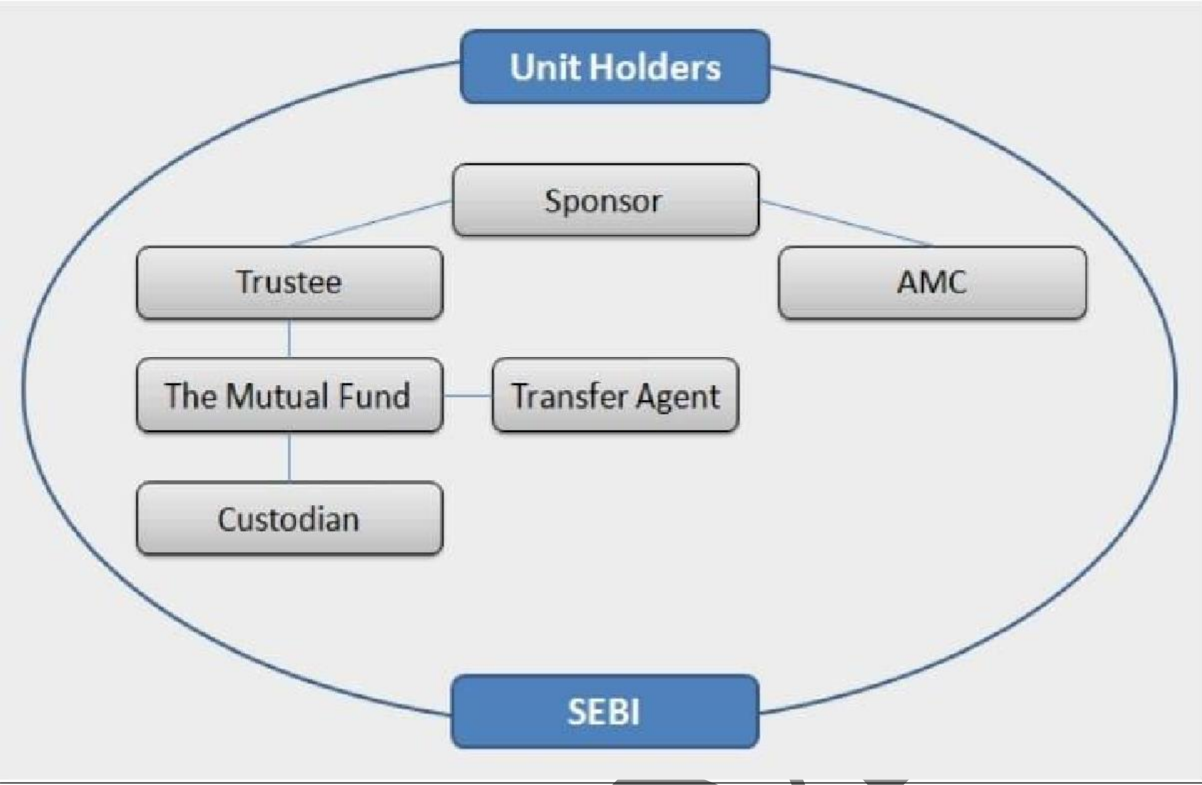
- Mobilize the savings of the relatively small investors.
- Channelize these small savings into productive investments.
- Distribute the large scale economies among small income groups.
- Encourage savings of lower and middle-class people.
- Sell units to investors in different parts of the country.
- Convert the small savings into industrial finance.
- To give investors an opportunity to share the benefits and fruits of industrialization in the country.
- Provide liquidity to units.
- Accept discount, purchase or sell bills of exchange, warehouse receipt, documents of title to goods etc.,
- To grant loans and advances to investors.
- To provide merchant banking and investment advisory service to investors.
- Provide leasing and hire purchase business.
- To extend portfolio management service to persons residing in other countries.
- To buy or sell or deal in foreign currency.
- Formulate a unit scheme or insurance plan in association with GIC.
- Invest in any security floated by the RBI or foreign bank.

Mutual funds:

The structure of mutual funds in India is a three-tier one with few other significant components. The three-tier structure comprises the fund sponsor, trustees and the asset management company.

Not only different banks or AMCs create or float mutual fund schemes. There are other entities involved that play a significant role in the structure of mutual funds. Moreover, the structure of mutual funds came into existence under SEBI Mutual Fund Regulations,1996. It plays the role of primary watchdog for all transactions. Thus, the inception of these regulations has revolutionised the structure of mutual funds, and all entities are regulated under it.

Organisation Structure of Mutual Funds in India:



(1) Sponsor: Promoter of the Mutual Fund Company is known as sponsor of the mutual fund. Sponsor either on his own or in partnership with another company establishes a mutual fund with a purpose to earn money from fund management through its subsidiary company. The company which manages the funds as Investment Manager of the Fund is called AMC.

(2) Trustee: Sponsors create trust through trust deeds in the favour of trustees. Trustees manage the trust and they are primarily responsible as guardians to investors in Mutual Funds. Primary responsibility of Trustees is to ensure that due diligence is complied with. All Funds floated by the AMC have to be authorised by the trustees.

(3) AMC: Sponsor starts Asset Management Company and AMC manages funds of the Trust. It charges a small fee to manage trust funds. The AMC plans all schemes, launches the scheme and sources the initial amount, manages the funds and gives services to the investors. Fund Managers are appointed by AMC to manage various MF schemes floated by an AMC.

(4) Custodian: In Mutual funds, AMC purchases different securities like Shares, bonds, gold etc. in various schemes. These Securities are purchased in the name of Trust but they are not kept in the custody of the Trust. The responsibility of safe keeping the securities is with the custodian Now a days the custody of financial securities are in demat form.

(5) Registrar & Transfer Agent: Registrar and Transfer agent is a separate entity. Registrar & Transfer agent has a responsibility of performing many administrative jobs like processing of applications of investors, generating units when new application is received, removing units when investors submit redemptions, managing full record of investors and processing dividend payments on behalf of its mutual fund client

Functioning of mutual funds:

A mutual fund is an investment vehicle that pools money from various investors and uses the money hence pooled to invest in the stock market. Assets such as equities, bonds, and other financial instruments are some examples of what mutual funds invest in. Mutual funds can be actively managed funds or passively managed funds. In actively managed funds, the fund manager performs market research to align the portfolio with the fund's objective. While passively managed funds replicate the index or benchmark. For example, exchange traded fund (ETF) and index fund.

Growth of mutual funds:

Growth of Mutual Fund Industry Expected in India in the Current Year and the Forthcoming Years

In 2022, it is estimated that there will be around 1.88 crores registered mutual fund investors in India as against 1.86 crore households with an annual income of more than Rs 10 lakh per annum. The number of mutual funds being offered, compared to previous years, is also increasing at an exponential rate.

A few years ago, only three major funds were being offered by all the leading financial institutions like HDFC MF and ICICI Prudential MF etc., whereas today there are nearly 50 different schemes available with every financial institution offering a wide range of products under various categories such as equity funds, balanced funds etc., which makes it difficult for investors to choose from among them.

The industry has grown rapidly over the last few years, with a growth rate of almost 40% per year. In 2022, it is expected that this rate will remain at around 30%

Regulation of mutual funds in India:

The term "regulation" means a rule or directive made and controlled by an authority.

- Mutual funds are regulated by the Securities and Exchange Board of India (SEBI).
- In 1996, SEBI formulated the Mutual Fund Regulation.
- SEBI is additionally the apex regulator of capital markets and its intermediaries.
- The issuance and trading of capital market instruments also come under the purview of SEBI.
- Along with SEBI, mutual funds are regulated by RBI, Companies Act, Stock exchange, Indian Trust Act and Ministry of Finance.
- RBI acts as a regulator of Sponsors of bank-sponsored mutual funds, especially in the case of funds offering guaranteed returns.
- In order to provide a guaranteed returns scheme, a mutual fund needs to take approval from RBI.

- The Ministry of Finance acts as a supervisor of RBI and SEBI and appellate authority under SEBI regulations.
- Mutual funds can appeal to the Ministry of finance on the SEBI rulings.

AMFI:

The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

Role of AMFI:

The most important role of AMFI in Mutual Fund is to help protect the interest of Indian investors, as well as that of the asset management companies. It also aids in making investments transparent and more accessible to attract more people to it.

Therefore, in a bid to make Mutual Fund investments more accessible, fund houses, trustees, advisors, intermediaries and other concerned individuals should register under AMFI through its website. As of now, it has 44 registered members, including 42 Asset Management Companies registered under SEBI.

To promote transparency regarding the Mutual Fund market, even the advertisements put forth by AMFI inform investors about the risks associated with them.

IRDA: The Insurance Regulatory Development Authority of India (IRDAI) is a regulatory body created with the aim of protecting the policyholder's interest. It also regulates and sees to the development of the insurance industry.

Role of IRDA :

- IRDAI issues a certificate of registration to the life insurance company and also renews, modifies, withdraws, suspends and cancels the registration.
- The regulatory body secures policyholder's interests in areas like assigning of policy, nomination by policyholders, insurable interest, settlement of insurance claim, surrender value of the policy, and other terms and conditions applicable to an insurance contract.
- It specifies the requisite qualifications, code of conduct and practical training required for insurance intermediaries and agents.
- IRDAI makes certain that the code of conduct is followed by surveyors and loss assessors.
- The autonomous body promotes efficiency in the conduct of the insurance business.
- It also promotes and regulates professional organisations connected with the insurance and reinsurance business.
- It levies fees and other charges for carrying out the purposes of the IRDAI Act.

- IRDAI carries out functions like inspection, conducting inquiries and investigations, including an audit of the insurers, insurance intermediaries and other organisations involved with the insurance business.
- The rates, advantages, terms and conditions that may be offered by insurers with respect to general insurance business are also controlled and regulated by the regulatory body.
- It also specifies the form and manner in which books of account should be maintained, and the statement of accounts should be rendered by insurers and insurance intermediaries.
- IRDAI monitors the investment of funds by insurance companies and governs the maintenance of the margin of solvency.
- It also judges the disputes between insurers and intermediaries or insurance intermediaries.
- It supervises the functioning of the Tariff Advisory Committee. IRDAI specifies the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f).
- It specifies the percentage of life insurance and general insurance business to be undertaken by the insurer in the rural or social sector.

Challenges faced by Insurance sector:

1. Increased Competition

Over the past few years, the P&C carriers' capacity to insure has steadily grown. This supply-led market will be one of the key P&C insurance trends that will intensify further with time. As the insurance industry continues to add capacity, this can be attributed to new players that offer their services online. These changing dynamics have intensified the price-based competition, driven market expansion into new geographies, and motivated insurers to develop new products.

2. Technology Advancements

Augmented reality, networked devices, and other emerging digital technologies have shown new avenues, which can create new revenue opportunities for insurance carriers. It is advantageous for managing industry operations. But, the slow pace of transformation is making it one of the most grievous insurance industry problems. Technology advancements are responsible for rapid changes in customers' behaviour and expectations. However, insurance industries are struggling to keep up with this technological evolution. Investment in digital platforms and solutions has become essential to enhance operational efficiency and reduce risk exposures.

3. Out-dated Technology Infrastructure

Out-dated P&C insurance technology infrastructure (legacy policy and underwriting systems) is obstructing the insurer's growth and ability to regulate operational cost, business demands, and customer requirements. With advanced analytics, robotic process automation, and other emerging applications, insurers today have possibilities to streamline core operational processes such as sales and P&C underwriting.

4. Rising Costs of Operations

Another issue that tops the list of insurance industry problems is the rising cost of operations. With out-dated software; one has to dedicate more resources to do the job which could be done quickly and efficiently by a comprehensive modern system. There are many statutory reports and mandatory audit reports that are to be shared with government agencies and regulatory bodies. Companies spend a lot of human resources and time to get these reports prepared and reviewed, but with an electronic system, these reports can be quickly generated, reviewed, and even shared.

5. Customer Engagements

The digital disruption has put the spotlight back on the customer. Customer engagement demands on-going customer focus, operational efficiency, process and people excellence, product-service innovation, agility and organizational alignment. With the changing digital landscape, the company needs to reassess its business model with a greater focus on customers with a customized value proposition.

6. Business Intelligence

A new era of business intelligence is upon us, which focuses on leveraging data to make an informed decision and gain a competitive advantage. While data is an asset, it needs to be managed appropriately. Data captured from various digital sources helps carriers mitigate loss, improve P&C underwriting, manage pricing, personalize products and enrich the customer experience.

MODULE-3

Financial and Securities Markets:

Call-Money Market:

- Call money, also known as "**money at call,**" is a short-term financial loan that must be **paid in full and immediately when the lender demands it.**
- Unlike a term loan, which has a fixed maturity and payment schedule, call money does not have to adhere to a set schedule, nor does the lender have to provide any advance notice of repayment.
- Call money is any type of **short-term, interest-bearing loan** that the borrower must repay immediately if the lender demands it.
- Call money allows **banks to earn interest on their excess funds**, which is known as the **call money rate (call loan rate/call rate)**.

- It consists of overnight money as well as money available on short notice for up to 14 days.
- The call money market primarily serves to **rebalance banks' and other participants' short-term liquidity positions**.

Structure:

- A call money loan is a short-term, interest-bearing loan made by one financial institution to another financial institution.
- Because of the loan's short term, it does not have regular principal and interest payments, which longer-term loans may have.
- The call loan rate is the interest rate charged on a call loan between financial institutions.
- Brokers use call money as a short-term source of funding to keep margin accounts open for their customers who want to leverage their investments.
- The funds can be transferred quickly between lenders and brokerage houses. As a result, it is the second most liquid asset on a balance sheet, trailing only cash.
- If the lending bank calls the funds, the broker can issue a margin call, which typically results in the automatic sale of securities in a client's account (to convert the securities to cash) to repay the bank.
- The interest rate charged on loans used to purchase securities, known as margin rates, varies according to the call money rate set by banks.

Functions:

- The call money market is run by brokers who keep in touch with the city's banks and connect the borrowing and lending banks.
- The market's primary function is to redistribute the pool of day-to-day surplus funds of banks among other banks in temporary cash deficits.
- Call money is used to meet the day-to-day cash needs of banks. Banks that are short on cash borrow from other commercial banks for a period of 1-14 days.
- Call-money is the term used when a bank borrows money for a single day. Notice money is any money borrowed for more than one day but no more than 14 days.
- The call rate is the rate at which these transactions take place. As a result, banks use call money to fill temporary fund mismatches and maintain short-term liquidity. It is the focal point through which the RBI can influence interest rates.

Government Securities Market

T- Bills Market:

Treasury bills, also known as T-bills, are short term money market instruments. The RBI on behalf of the government to curb liquidity shortfalls. It is a promissory note with a guarantee of payment at a later date. The funds collected are usually used for short term requirements of the government. It is also used to reduce the overall fiscal deficit of the country. Treasury bills or T-bills have zero-coupon rates, i.e. no interest is earned on them. Individuals can purchase T-bills at a discount to the face/value. Later, they are redeemed at a nominal value, thereby allowing the investors to earn the difference.

Commercial Paper

Commercial paper is a money-market security issued (sold) in the commercial paper market by large corporations to obtain funds to meet short-term debt obligations (for example, payroll) and is backed only by an issuing bank or company promise to pay the face amount on the maturity date specified on the note.CPs have a minimum maturity of seven days and a maximum of up to one year from the date of issue. However, the maturity date of the instrument should typically not go beyond the date up to which the credit rating of the issuer is valid. They can be issued in denominations of Rs 5 lakh or multiples thereof.

Certificate of Deposits

A certificate of deposit (CD) is a savings product that earns interest on a lump sum for a fixed period of time. CDs differ from savings accounts because the money must remain untouched for the entirety of their term or risk penalty fees or lost interest. CDs usually have higher interest rates than savings accounts as an incentive for lost liquidity.

Almost all consumer financial institutions offer CDs, although it's up to each bank which terms it wants to offer, how much higher the rate will be compared to the bank's savings and money market products, and what penalties it applies for early withdrawal.

A certificate of deposit (CD) is a savings account that holds a fixed amount of money for a fixed period of time, such as six months, one year, or five years, and in exchange, the issuing bank pays interest. When you cash in or redeem your CD, you receive the money you originally invested plus any interest. Certificates of deposit are considered to be one of the safest savings options. As with all investments, there are benefits and risks associated with CDs. The disclosure statement should outline the interest rate on the CD and say if the rate is fixed or variable. It also should state when the bank pays interest on the CD, for example, monthly or semi-annually, and whether the interest payment will be made by check or by an electronic transfer of funds. The maturity date should be clearly stated, as should any penalties for the "early withdrawal" of the money in the CD. The risk with CDs is the risk that inflation will grow faster than your money, and lower your real returns over time.

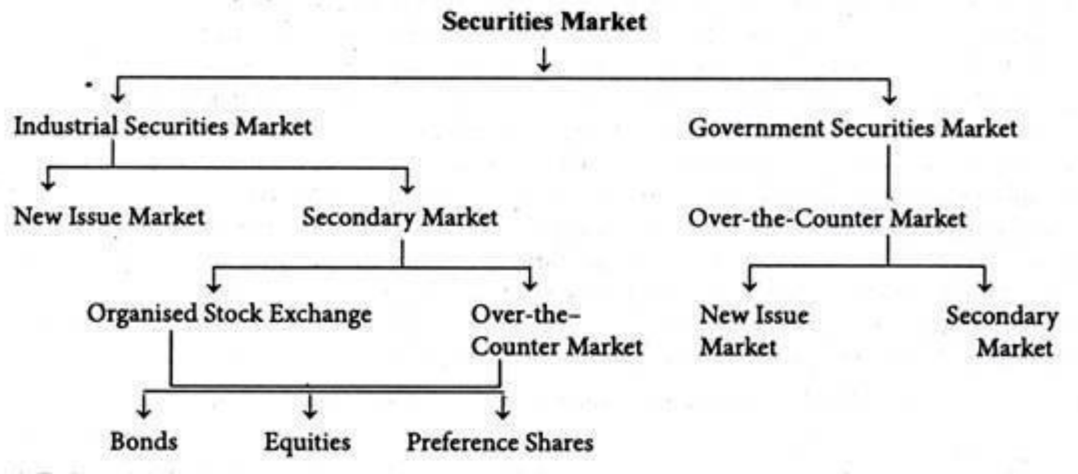
MODULE 3(B):

Securities Markets-Organization and Structure:

Industrial Securities Market:
The Industrial securities market refers to the market for shares and bonds of the existing companies, as well as those of new companies.

This market is further divided into New Issue Market (NIM) and Old Issue Market. The New Issue Market is also called Primary Market. Likewise, the Old Issue Market is also called Secondary Market or Stock Exchange.

Table 40.1. The Structure of Securities Market



However, it is important to emphasize that the New Issue Market and Stock Exchange are interlinked and work in conjunction with each other. Although they differ from each other in the sense that the New Issue Market deals with 'new securities' issued for the first time to the public and Stock Exchange deals with those securities which have already been issued once to the public.

(i) Primary Market:

The primary market is concerned with the floatation of new issues of shares or bonds. The firms floating new issues to raise funds may be new companies or existing companies planning expansions. The Merchant Banking Division of a commercial bank is asked by the company to advise on the viability Of floatation of an issue before an issue is actually floated in the market.

The stock issuing company also approaches the institutional underwriters like LIC, UTI, ICICI and IDBI, to ensure the marketability of an issue. The underwriters like LIC and UTI purchase securities from the New Issue Market to hold these in their own asset portfolio.

In Indian capital market, there are two main ways of floating new issues:

(a) Public issues, and

(b) Rights issues.

(a) Public Issues:

The most popular method for floating securities in the New Issue Market is through a legal document called the "Prospectus". It is an open invitation to the public to subscribe to the issue at par or at premium.

(b) Right Issues:

This method of the sale of stock is normally used by existing companies whose shares are already listed in the Stock Exchange. Right issue represents an invitation to the existing shareholders to subscribe to a part or the whole of the new issue in a fixed proportion to their shareholding.

Resource mobilisation through primary markets by Indian corporate companies is shown in Table 40.2 for the years 2007-08 to 2010-11. The primary capital market progressed significantly in 2009-10 and 2010 -11 after the setback in 2008-09. The amounts of funds raised and the number of new issues which entered the primary market increased in 2009-10 and 2010-11.

The total amount of capital raised through equity issues in 2009-10 was Rs. 46,736 crore as against Rs. 2082 crore in 2008-09. Due to the global financial crisis in 2008, the primary capital market received a setback in 2008-09. The number of new issues declined sharply in 2008-09.

Total amount of capital raised through equity issues during 2010-11 was Rs. 48,654 crore. The total number of initial public offerings (IPOs) in 2010-11 was only 55 as against 85 in 2007-08 and 39 in 2009-10. The amount mobilized by IPOs in 2010-11 was Rs. 35,569 as against Rs. 24,696 crore in the whole year 2009-10.

The mean IPO size increased from Rs. 033 crore in 2009-10 to Rs. 671 crore in 2010-11. There was debt issue (i.e. issue of corporate bonds and debentures) to the tune of Rs. 2,500 crore in 2009-10 and Rs. 9,451 crore in 2010-11. There was no debt issue in 2007-2008. As will be seen from Table 40.2 the amount of capital mobilized through private placement in 2010-11 was Rs. 2,18,785 crore as compared to Rs. 2,12,635 crore in 2009-10.

In the financial year 2011-12 resource mobilisation through the primary market was still greater. Rs. 35,611 crore was raised through sale of bonds by the corporate sector (i.e., through debt mode) and Rs. 12,857 crore was raised through issue of equity and Rs. 2,61,282 crore were raised through primary primate placement. In this way the total of Rs. 3,09, 750 crore were raised during the financial year 2011-12. During the financial year (up to December 2012-13) resource mobilisation through primary market witnessed an upward movement and a total of Rs. 2, 81,667 crores were raised in the first three quarters of 2012-13 (See Table 40.2).

Table 40.2. Resource mobilization through primary market

(₹ *crore*)

	Mode	2007-08	2008-09	2009-10	2010-11*	2011-12	2012-13*
1.	**Debt**	0	1,500	2,500	9,451	35,611	4,974
2.	**Equity**	54,511	2,082	46,736	48,654	12,857	13,050
	of which, IPOs	42,595	2,082	24,696	35,569	5,904	6,043
	Number of IPOs	85	21	39	55	34	20
	Mean IPO size	501	99	633	671	174	302
3.	**Private placement**	1,18,485	1,73,281	2,12,635	2,18,785	2,61,282	2,63,644
4.	**Euro issues (ADR/GDR)**	NA	NA	NA	NA	NA	NA
	Total (1 + 2 + 3 +4)	2,16,176	1,79,066	2,81,871	2,76,890	3,09,750	

Initial Public Offer (IPO):

As is seen from Table 40.2, the equity capital may be raised through IPO. IPO or Initial public offer is the first issue of shares by a corporate company to the general public to raise capital for expansion of its business. IPO is followed by a listing of its shares in the stock market. The issue of IPO by the Indian companies and the price of share that is fixed is regulated by SEBI. IPOs may be issued through the "Fixed Price Method" or through the book Building Procedure. In 2007-08 there were 85 IPOs but the number of IPOs declined to 39 only in 2009-10. In 2008-09, when the global financial crisis hit the Indian economy, the number of IPOs had declined to only 21.

Private Placement:

It will be seen from Table 40.2 that a lot of capital is raised through private placement. An unlisted company which wants to raise equity funds but is not yet prepared to make an IPO may place privately its equity or equity related instruments with one or more sophisticated investors such as financial institutions, mutual funds, venture capital funds, banks etc.

The private placements can be made by a company to the investors at any agreed price and quantity as such private equity issues are not regulated by SEBI. The Securities and Exchange Board of India (SEBI) has affected several reforms in the New Issue Market. These reforms seek improved disclosure standards, prudential norms and simplification of issue procedures.

Improvements in Resource Mobilisation from the Primary Market:

During April-May 2013, the total resource mobilisation from the primary equity market more than doubled to Rs. 9.3 billion compared with Rs. 3.9 billion mobilized during April-May 2012 (Table 40.3). The higher resource mobilisation in equity was due to a recovery in the secondary market and the floatation of a mega issue in May 2013. Resource mobilisation via the private placement route continued its growth momentum.

During April-May 2013, mobilisation through private placements increased by nearly 59 per cent to Rs. 756 billion as compared to Rs. 475 billion in the corresponding period last year. Led by private sector mutual funds, resources mobilized by mutual funds during April-June 2013 also registered an increase to Rs. 956 billion as against net sales of Rs. 4,995 billion during April-June 2012.

Table 40.3. Primary Market Trends

Category		2012-13 (Apr-Mar)	2012-13 (Apr-June)	2013-14 (Apr-June)
1		2	3	4
a.	**Public Issue (*i*) + (*ii*)**	**219**	**4***	**11***
	(*i*) Public Issue (Equity)	65	4*	9*
	of which : IPOs	65	4*	9*
	FPOs	0	0*	0*
	(*ii*) Public Issue (Debt)	154	0*	1*
b.	Rights Issue	89	1*	0*
	Total Equity Issues (i + b)	**155**	**4***	**9***
c.	Euro Issues (ADR/GDR)	10	2	1
d.	Mutual Fund Mobilisation (net)	765	-4995	956
	(*i*) Private Sector	638	-3985	774
	(*ii*) Public Sector	127	-1010	182
e.	Private Placement in Corporate Debt market	3615	475*	756*
f.	QIP	160	0.3*	32*

(ii) Secondary Market:

The Secondary Market deals in existing securities. This market provides both liquidity and marketability to such securities. It implies that it is a market where a security can be bought or sold at small transaction cost. Although the Secondary Market deals with the purchase and sale of old securities, the firms issuing new securities get themselves registered on a Stock Exchange by applying for listing of shares. Listing offers the investor a 'market' for the sale of his stock.

The Secondary Market of Securities in India functions through its following two segments:

(a) Stock Exchange;

(b) Over-the-Counter Market.

Stock Exchange:

Stock Exchange is an organised market for the purchase and sale of second-hand listed industrials and financial {i.e., shares and debentures of corporate companies). Listed securities are those securities which appear on the approved list of a Stock Exchange. Only listed securities are traded on the floor of the Stock Exchange. It is to be noted that an organised Stock Exchange is an 'auction' type of market, where the prices of traded securities are settled by open bids and offers on the floor of the exchange.

In a Stock Exchange, the transactions in stocks can be classified into two types:

(a) Investment transactions; and

(b) Speculative transactions.

Investment Transactions:

An investment transaction in securities is that transaction which is concerned with the purchase of securities, with a view to investing funds to get an income as annual dividends from these securities and gain from the sale of these securities. The basic feature of an investment transaction is that it involves the actual delivery of the security and payment of its full price. An investment transaction is motivated by the considerations of safety of investment and security of income.

Speculative Transactions:

The speculative transaction in securities is that transaction which is concerned with the purchase or sale of securities for the sake of capital appreciation. The basic feature of a speculative transaction is that the delivery of securities or the payment of the full price are rare.

The speculator neither takes delivery of the securities sold by him; instead he only receives or pays the difference between the purchase and sale prices, as the case may be. The trading in securities, without the intention of taking delivery or making payment, is called forward trading. Under the Securities Contract (Regulation) Act. 1956 forward trading was perfectly legal till it was suspended in 1969 along with all the regulatory and penal measures.

The suspension of forward trading created a real vacuum in the stock market. The stock brokers devised the extra-legal badla system to fill up this vacuum. Under this badla system, securities contract was turned into a carry-forward instrument merely by closing the contract on the 14th day and replacing it by a new hand-delivery contract between the same buyer and seller in respect of the same securities.

Thus, only the difference between the ‘contract price’ and the ‘market price’ would change hands between the buyer and the seller. Badla transactions became the predominant form of Stock Exchange transactions. Since real transactions involving the transfer of securities became a microscopic minority, a serious problem of excessive speculation developed in the stock market. In short, the badla system led to excessive speculation and short-selling often amounting to gambling. The Securities and Exchange Board of India (SEBI) banned the badla system in December 1993.

There was an increasing demand for legitimate forward trading to give a boost to the stock market. Since stock market quotations are often considered as the barometers of a country’s economy, the SEBI and the Government should stimulate the stock market. The SEBI, therefore, reintroduced badla (forward trading) on July 27, 1995. Now, with the introduction of derivatives in the stock market the same purpose is served by the derivatives called futures as the old badla system.

The Bombay Stock Exchange is one of the 15 recognized Stock Exchanges in India. This Stock Exchange is popularly known as Dalai Street Stock Market. It handles around three-fourth of the total trading in securities in India.

The number of companies listed on the Bombay Stock Exchange at the December-end 1993 was 3,585. Thus the number of listed companies was even larger than in the developed countries' stock markets of Japan, UK, Germany. Canada and France. During the last two years several reform measures have been taken with regard to the working of the secondary market. The important changes are explained below.

Rajiv Gandhi Equity Savings Scheme:

On 23rd November 2012, the government notified a new tax saving scheme called the Rajiv Gandhi Equity Savings Scheme (RGESS), exclusively for first-time retail investors in the securities market. This scheme provides 50 per cent deduction of the amount invested from taxable income for that year to new investors who invest up to Rs. 50,000 and whose annual income is below Rs. 10 lakh. The operational guidelines were issued by SEBI on 6 December 2012.

Electronic Voting Facility made mandatory for top listed companies:

As mandated in the Union Budget 2012-13 for top listed companies to offer electronic voting facility to their shareholders, SEBI has come out with the necessary amendments in this regard on 13 July 2012, to be incorporated in the equity listing agreement by stock exchanges. To make a beginning, based on market capitalization, electronic voting is now mandatory for the top 500 listed companies at the BSE and NSE, in respect of those businesses to be transacted through postal ballot.

SME Exchange/Platform:

Separate trading platforms for SMEs were launched and became functional at the BSE and NSE in March 2012 and September 2012 respectively. As on 14 January 2013, the number of equities listed on the BSE and NSE SME platforms is 12 and 2 respectively.

Reduced Securities Transaction Tax for cash delivery transactions:

Following the announcement in Union Budget 2012-13, the rate of the securities transaction tax (STT) has been revised downwards by 20 per cent to 0.1 percent from 0.125 percent for delivery-based transactions in the cash market, effective 1 July 2012.

Regulatory framework for governance and ownership of stock exchanges, clearing corporations, and depositories:

Based on the recommendations of the Dr. Bimal Jalan Committee, new Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations 2012 were notified on 20 June 2012 to regulate recognition, ownership, and governance in stock exchanges and clearing corporations, Further, the Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations 2012 have been brought into effect from 11 September 2012 to regulate ownership and governance norms of depositories.

Expansion of Qualified Foreign Investors (QFIs) Scheme:

In Budget 2011-12, the government, for the first time, permitted qualified foreign investors (QFIs), who meet the know-your-customer (KYC) norms, to invest directly in Indian MFs. In January 2012, the government expanded this scheme to allow QFIs to directly invest in Indian equity markets.

Taking the scheme forward, as announced in Budget 2012-13, QFIs have also been permitted to invest in corporate debt securities and MF debt schemes subject to a total overall ceiling of US $ 1 billion. In May 2012, QFIs were allowed to open individual non-interest-bearing rupee bank accounts with authorized dealer banks in India for receiving funds and making payment for transactions in securities they are eligible to invest in. In June 2012, the definition of QFI was expanded to include residents of the member countries of the Gulf Cooperation Council (GCC) and European Commission (EC) as the GCC and EC are the members of the Financial Action Task Force (FATF).

Initiatives to attract FII Investment:
As regards FII investment in debt securities, there has been progressive enhancement in the quantitative limits for investments in various debt categories. In June 2012, the FII limit for investment in G-Secs (government securities) was enhanced by US $ 5 billion, raising the cap to US $ 20 billion. The scheme for FII investment in long-term infra bonds has been made attractive by gradual reduction in lock-in and residual maturity periods criteria.

In November 2012, the limits for FII investment in G- Sees and corporate bonds (non-infira category) have been further enhanced by $ 5 billion each, taking the total limit prescribed for FII investment to US $ 25 billion in G-Secs and US $ 51 billion for corporate bonds (infra + non-infra). FII debt allocation process has also been reviewed for bringing greater certainty among foreign investors and helping them periodically rebalance their portfolios in sync with international portfolio management practices.

Establishment of National Stock Exchange:
An important step to provide an efficient and transparent stock market culminated in the establishment of National Stock Exchange of India (NSEI) in July 1994. The NSEI opened membership to 13 cities, including Bombay, the commercial capital of India. The NSEI operates in its two segments: (i) Wholesale Debt Market (WDM) and (ii) Capital Market (CM): In the Wholesale Debt Market. Government Securities, Treasury Bills, Public Sector Undertaking (PSU) bonds, Certificates of Deposits, Commercial Papers and Corporate Debentures are traded in.

The main participants in this market are banks., financial institutions and large corporate firms. The RBI has directed banks to use only the NSEI for all transactions in debt securities instead of using the services of brokers so as to ensure transparent and regulated deals.

In the capital market segment of NSEI, equities are traded in. In the capital market segment of NSEI, the number of securities admitted to trading has expanded from 200 to start with to 525 by December 1994. Thus, the National Stock Exchange of India (NSEI), with its scrip-less trading system, can be regarded as a milestone in the development of the stock market in India.

In short, stock exchanges, as a secondary market in industrial securities, furnish an important mechanism of imparting liquidity in the Indian capital market. Of late, SEBI has evolved certain guidelines of rules and regulations to make stock exchanges to function in accordance with the principle of safety of the market, transparency and investor protection. The liberalisation, privatization and globalisation (LPG) of the Indian economy has led to the increase in the volume of business in industrial securities in both the New Issue Market and Secondary Market (stock exchange) of the Indian capital market.

Government Securities Market:
The term ‘gilt edged’ means the ‘best quality’. Since Government Securities are of best quality in the sense of liquidity and zero degree of the risk of default, these are called gilt-edged securities. In the Gilt-edged Market, the securities of the Government of India and of the State Governments are traded in. The securities guaranteed (as to both principal and interest) by the Government are also traded in this market.

The importance of Government Securities Market, that is, Gilt-edged Market, as a segment of the capital market, emanates from the fact that this market provides a mechanism for the management of public debt and open market operations to the Reserve Bank of India (RBI). It is, therefore, imperative to emphasize that this market has a strong bearing on the formulation of the fiscal policy of the Government of India and the monetary policy of RBI. The Gilt-edged Market has two segments: Treasury Bill Market and Government Bond Market.

The Treasury Bill Market is a source of short term funds for the Government. A Treasury Bill is a promissory note, that is, a liability of the Government of India. The Treasury Bills are of the maturity period of 91 days, 182 days and 364 days. The RBI sells Treasury Bills on behalf of the Government of India. It is important to point out that RBI is the chief holder of these bills. Outside it, commercial banks hold these bills. Thus, the Treasury Bills Market is a captive market.

The Indian Treasury Bills Market is underdeveloped as compared to the U.S.A. and U.K. However, recently RBI has initiated certain reforms in the Treasury Bill Market to transform its captivity character to broad-based market character. The RBI reduces its holdings of Treasury Bills by converting them into dated-Government Securities at market-related interest rates.

The 364 days Treasury Bills are entirely held by the market. The Government of India’s borrowings from RBI through Treasury Bills to cover budget deficit is called monetisation of deficit. In order to contain direct and automatic monetisation of budget deficit, the Finance Secretary, Government of India and the Governor, Reserve Bank of India signed an agreement on September 9, 1994 to limit borrowing through ad hoc Treasury Bills to Rs. 6000 crore in 1994-95. It is an important step to strengthen the efficacy of monetary management by the RBI. It would also help to control inflation in the economy.

‘The Government Bond Market is a source of long-term funds to the Government of India and State Governments. The Government bonds are dated securities which are floated to raise medium and long-term loans in the open market. It is significant to note that it is generally the institutions, instead of individuals, that are the buyers of Government bonds.

It is due to relatively lower interest rate, long maturity period and face value in high denominations that the individuals are found to be reluctant to invest their funds in Government bonds. The institutions like commercial banks, LIC and G1C buy the Government bonds to build up their asset portfolio.

These institutions invest in Government bonds as they are required by law to invest a certain minimum proportion of their total funds in these bonds. Left to themselves, they would not like to buy these bonds owing to the low interest rate on them. The RBI, as a manager of public debt, operates on the supply side of the Government bond market. At the end of the subscription period, RBI holds the stock of unsold Government bonds and keeps them selling on its own account.

The Government bond market is a captive market. The RBI is launching a system of primary dealers for deepening and expanding the Government bond market. The Securities Trading Corporation of India was set up in 1993-94 to develop the secondary market in Government securities.

Growth of Central Government's Securities:
The growth of the Securities Market is an integral part of the process of economic growth in a free market economy. Of late, the RBI and the Government of India have pursued certain measures to reform the Securities market. These reforms have been introduced in both the New Issue Market and the Secondary Market of industrial securities and Government securities.

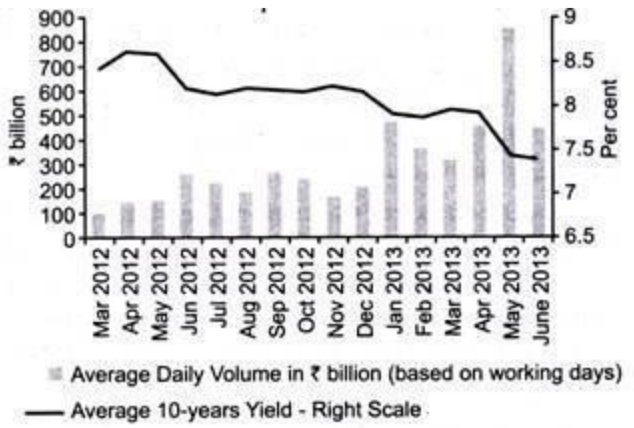


Fig 40.4. *Average Daily Volume and 10-Year Weighted Average*

The average daily trading volume of central government securities in the secondary market increased to around Rs.570 billion during Q1 of 2013-14 from Rs. 376 billion during Q4 of 2012-13. The traded volume in G-secs generally varied inversely with G-sec yields.

The gross market borrowings of the central government through dated securities during 2013-14 were to the tune of Rs.2,100 billion (net borrowings of Rs. 1,972 billion) up to July 26, 2013 compared with Rs. 2,340 billion (net borrowings of Rs.1, 594 billion) during the corresponding period of the previous year.

The weighted average maturity of the dated securities increased to 14.96 years from 13.62 years during the corresponding period of the previous year. The weighted average yield during the primary auctions eased to 7.64 per cent from 8.52 per cent during the corresponding period of the previous year.

The weighted average yield during the primary auctions eased to 7.64 per cent from 8.52 per cent during the corresponding period of the previous year (Table 40.9). The bid-cover ratio stood in the range of 1.41-6.09 as against 1.47-3.59 during the corresponding period of the previous year. The government availed of ways and means advances (WMA) on three occasions up to end-June 2013. As on July 16, 2013 the outstanding WMA position of the government was Rs. 3.06 billion.

Table 40.9 : Issuances of Central and State Government Dated Securities*

Item	2012-13	2013-14
1	2	3
Central Government		
Gross amount raised (₹ billion)	1880	1650
Development on primary dealers (₹ billion)	11.95	Nil
Bid-cover ratio (range)	1.47-3.59	2.38-6.08
Weighted average maturity (years)	13.38	17.92
Weighted average yield (per cent)	8.57	7.57**
State Government		
Gross amount raised (₹ billion)	310.9	379.1
Cut-off yield range (per cent)	8.80-9.31	7.57-8.51
Weighted average yield (per cent)	9.07	7.92

During 2013-2014 (up to July 16, 2013), 18 states have raised Rs. 401.2 billion on a gross basis (net amount of Rs. 252.3 billion) compared with Rs. 419.8 billion (net amount of Rs. 369.6 billion) raised by 20 states during the corresponding period of the previous year. The weighted average yield eased to 7.98 per cent up to July 16, 2013 from 9.01 per cent during the corresponding period of the previous year.

Clearing And Settlement Procedure In The Indian Stock Market

In the stock market, there is always a buyer and a seller. So, when a person buys a certain number of shares, there is another trader who sells the shares. This trade is settled only when the buyer receives the shares and the seller receives the money.

Let's see in detail how the process takes place

There are three phases in a secondary market transaction:

1. Trading

2. Clearing

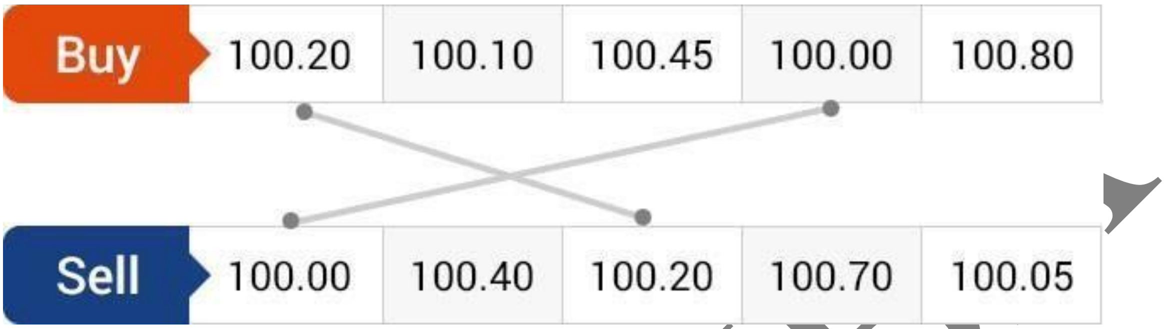
3. Settlement

- **Trading**

In the stock market, a large number of trades occur simultaneously. The stock exchanges use an electronic order matching system to match ‘buy’ and ‘sell’ orders from different traders. This way, each trade is executed.

For instance, imagine that stock ‘X’ is trading in the stock market.

The buy and sell orders for this stock are as follows:



Here the costliest buy prices are matched against the cheapest available sell prices, and whenever the buy price is less than or equal to the best available sell price a match is done. This of course also depends on the respective quantities available in the market across buys and sells and is known as market depth.

So even if a particular price may result in a match, if there is not enough quantity available at the seller's side at that price, the buy order will still not be fully traded.

The market depth is created by brokerages who collect orders from different investors and pass it on to the stock exchanges, most likely to be the two most popular exchanges in India — the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). In this process, brokerages act as the intermediary between the investor and the stock exchange.

- **Clearing**
  Once two orders match and a trade is executed, the clearing process takes place. Clearing is the identification of what security is owed to the buyer and how much money is owed to the seller. The entire process is managed by ‘clearing houses’. These are independent entities.
  For example, imagine that there are two traders: Ramesh and Suresh.
  However, in the real market scenario, traders tend to conduct multiple transactions. As a result, the clearing house identifies all the transactions and the net amount or net securities owed to the trader are calculated.

- **Settlement**
  The next step is to fulfil the financial obligations identified in the clearing step. This involves the transaction settlement for the buyers and sellers.
  So once the buyer receives the security and the seller receives the payment, the transaction is settled.

Types of settlements in the stock market

There are two types of settlements in equity investment that you will come across and they are as follows –

- **Spot settlement**
  This type of settlement is carried out immediately following the rolling settlement principle of T+2.
- **Forward settlement**
  This settlement is applicable when you agree to settle the trade later at a future date which could be T+5 or T+7.

What is rolling settlement?

A rolling settlement is one in which the trade is settled in the days following the trade. Trades are settled in T+2 days with this sort of settlement, which indicates that deals are closed after the second working day. Sunday, Saturday, Bank holidays, and exchange holidays are not included in this time frame. So, if a trade is made on a Tuesday, it will be closed on a Thursday. Similarly, if you buy a stock on Friday, you must pay the broker that day, but the shares will be deposited in your account the following Tuesday. You become the shareholder of record on the day that your trades are settled.

For dividend-seeking investors, the equity settlement day is important. If the buyer wants to collect a dividend from the company, he must settle the trade for a profit before the record date.

Rolling settlement rules in BSE

- In the Bombay Stock Exchange (BSE), the shares are all settled in T+2 days.
- Government securities and fixed income securities for retail investors are also closed in T+2 days.
- Pay-in and pay-out when you buy or sell securities are executed on the same day of the trade.
- The securities are deposited by the client within one working day after the BSE completes the pay-out of the funds and securities.

Settlement cycle on the NSE

The cycle for rolling equity settlements on the National Stock Exchange (NSE) is as follows:

Activity	Working Days
Rolling Settlement Trading	T
Clearing Including Custodial Confirmation and Delivery Generation	T+1
Settlement Through Securities and Funds Pay-In and Pay-Out	T+2
Post Settlement Auction	T+2
Auction Settlement	T+3
Reporting for Bad Deliveries	T+4
Pay-In-Pay-Out of Rectified Bad Deliveries	T+6
Re-Reporting of Bad Deliveries	T+8
Closing of Re-Bad Deliveries	T+9

Participants Involved in the Process

- **Clearing Corporation**

Clearing corporation is one of the major participants involved in the clearing and settlement process in the stock market. The responsibility for clearing and settlement of trade executed at the stock exchange lies with the National Securities Clearing Corporation Limited (NSCCL). It is also in charge of risk management and is obligated for meeting all settlements regardless of the member defaults.

- **Clearing Members/Custodians**

They are another participant in the clearing and settlement process in Indian stock market. When trading members place deals in the stock exchange, the same is moved to NSCCL, which transfers them to the clearing members. The clearing member is in charge of determining the position of share to suit the trade.

- **Clearing banks**

Clearing banks are responsible for the settlement of funds. There are 13 clearing banks, and each clearing member needs to open a clearing account with either one of them. In case of a pay-out, clearing members receive funds in the clearing account and in case of pay-in they need to make funds available.

- **Depositories**

There are two depositories in India – National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL). These two depositories hold your Demat account, and clearing members also need to maintain a clearing pool account with them.

Clearing members need to transfer the securities to the clearing pool account they hold with the depositories on the date of settlement.

- **Professional Clearing Members**

These are special category members appointed by the NSCCL. However, note that they are not allowed to trade, and they can only clear and settle trades executed for their clients. Professional clearing members generally constitute banks, custodians and so on.

How Trades are Cleared and Settled in the Stock Market?

- The stock exchange transfers the details of every trade to the clearing corporation on the T day when trade is executed.
- The clearing corporation confirms with the clearing members before they close the trade. Once they receive confirmation, they determine the obligations of the clearing member.
- After the details are confirmed the clearing banks must have sufficient funds, and depositories should make the shares available.
- The clearing corporations get funds and securities from clearing banks and depositories for purchase and sale transactions respectively.
- In the case of the purchase transaction, the clearing member receives securities and in the case of sale transaction, the clearing member receives money in the clearing account.

A Diagram for Clearing & Settlement Process

Remember

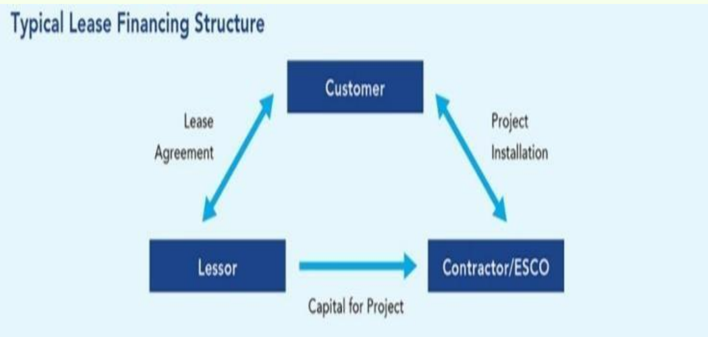
A trade in the stock market takes place in an instant. But for that to happen smoothly and efficiently, all these processes take place in the background. And knowing the whole process may help you understand how the stock market works better.

MODULE -4

Asset/Fund based Financial Services

Lease financing:

Meaning of Lease Financing— Lease financing is a contractual agreement between the owner of the asset who grants the other party the right to use the asset in return for a periodic payment and the other party who is the user of such assets. The owner of the party is known as Lessor and the user of the asset under such agreement is known as lessee and the rental paid is known as lease rental.



Merits of Lease financing

1. Cheap source—It enables the lessee to acquire the asset with a lower investment only.
2. No dilution of ownership—It provides the finance without diluting the ownership or control of the business.
3. Easy replacement of assets—The risk of obsolescence is borne by the lesser. This allows greater flexibility and cheap financing to the lessee to replace the asset.

4. Tax benefits—Lease rentals paid by the lessee are deductible for computing tax liabilities. It further reduces the cost of taking assets on lease.

Limitations of lease financing

1. Contractual constraints—A lease agreement may restrict the lessee to make any alteration or modification in the asset.

2. Renewal of lease agreement—The normal business operations and growth of the business is badly affected in case the lease is not renewed.

3. No capital gains—The lessee never becomes the owner of the asset in spite of paying heavy lease rentals. It deprives him of the residual value of the asset.

Consumer credit and hire purchase finance:

consumer credit, short- and intermediate-term loans used to finance the purchase of commodities or services for personal consumption or to refinance debts incurred for such purposes. The loans may be supplied by lenders in the form of cash loans or by sellers in the form of sales credit.

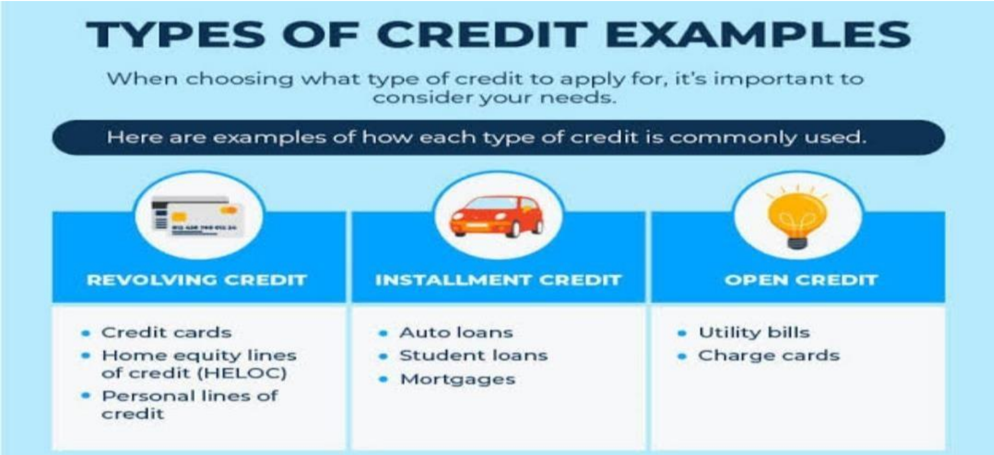
Consumer credit in industrialized countries has grown rapidly as more and more people earn regular income in the form of fixed wages and salaries and as mass markets for durable consumer goods have become established.

Britannica MoneyBond Market Basics: Here's What to Know

Consumer loans fall into two broad categories: installment loans, repaid in two or more payments; and non installment loans, repaid in a lump sum. Installment loans include (1) automobile loans, (2) loans for other consumer goods, (3) home repair and modernization loans, (4) personal loans, and (5) credit card purchases. The most common non installment loans are single-payment loans by financial institutions, retail-store charge accounts, and service credit extended by doctors, hospitals, and utility companies.

Finance charges on consumer loans generally run higher than the interest costs of business loans, although the way costs are quoted may disguise the actual charges. In the United States the Truth in Lending Act (part of the Consumer Credit Protection Act of 1968) requires lenders to state finance charges in ways that allow borrowers to compare the terms being offered by the lending companies.

The Consumer Credit Protection Act in the United States and the Consumer Credit Act (1974) and Consumer Protection Act (1987) in Great Britain are examples of legislation enacted to protect borrowers. Credit bureaus such as Equifax, Experian, and TransUnion provide information about an individual's creditworthiness to potential lenders. (Consumers may request a copy of their credit report.) Many organizations help consumers manage their credit.

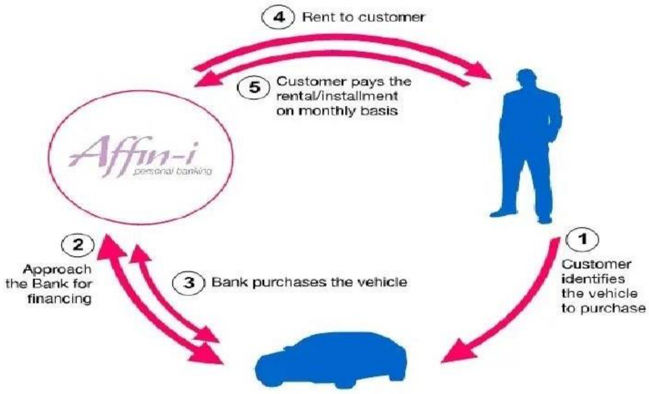


Hire purchase agreement:

A hire purchase (HP) agreement is a credit agreement. You hire an item (for example, a car, laptop or television) and pay an agreed amount in monthly payments. You do not own the item until you have made the final payment. Personal Contract Plans (PCPs) are a type of hire purchase agreement. Hire purchase can also be arranged through a retailer. If you take out a HP agreement with a retailer, you should know that the store or garage is not actually providing the loan. It is acting as an agent for a finance company and will earn commission from the finance company for arranging the loan. This is called being a credit intermediary and the agent must be authorised by the Competition and Consumer Protection Commission (CCPC) to do this. You can check if the agent is authorised by using the Register of Credit Intermediaries.

Hire purchase agreements usually last between 2 and 5 years. Most HP agreements last 3 years. You should read a hire purchase contract very carefully before committing yourself to any agreement.

Hire purchase agreements are covered by the Consumer Protection Code which gives you rights when you buy a financial product. Hire Purchase is regulated by the Consumer Credit Act 1995



Personal Contract Plans (PCPs)

This is a specific type of hire purchase agreement offered by car dealers as a way to pay for a car. In a PCP contract, you pay a deposit and continue to make regular installments, usually over 3 years. There is usually a large lump sum payment at the end of the contract.

At the end of the contract you can either:

- Pay the final lump sum and keep the car, or
- Return the car to the seller (you can take out a new PCP arrangement on another car)

You do not own the car until the final payment is made. You must stick to certain restrictions on usage and maintenance, such as mileage limits and servicing obligations.

PCPs can seem very attractive because they usually have very low monthly repayments but they can be very complex compared to other types of car finance. It is important to understand all the terms and conditions before you sign up for a PCP. You can find out more about PCPs from the Competition and Consumer Protection Commission (CCPC).

Hire purchase costs

To calculate the real cost of a hire purchase agreement:

1. Find the total hire purchase price
2. Find the price of a cash purchase of the same item
3. Deduct the cash price (2) from the total hire purchase price (1)

Example: A garage offers two prices for the same car. The car will cost you €12,000 if you buy it outright with cash. Alternatively, the car will cost you €17,000 if you want to hire purchase the car:

1. €17,000
2. €12,000
3. €17,000 - €12,000 = €5,000

In this example, the hire purchase cost is €5,000. That is, it will cost you €5,000 extra to hire the car for a period of time (and eventually to own it), rather than to buy it outright for cash.

Different lenders have different hire purchase costs. Some will quote an APR (Annual Percentage Rate). This can help you to compare hire purchase costs. It may be misleading to compare a hire purchase APR with that of a normal bank or credit union loan. This is because you are paying for the hire of the goods. Unlike a loan, you do not own them until the last instalment of the HP agreement has been paid.

There is a maximum interest rate of 23% APR for hire purchase agreements since 16 May 2022.

If you would like independent information or help understanding the terms and conditions of a HP agreement (or any other loan), you can contact the CCPC. If you are struggling with a HP debt, you can contact MABS for free and independent advice.

Hire purchase charges and fees

Hire purchase agreements may also involve additional fees and charges. These fees and charges vary, but may include:

- Documentation fees
- Penalty fees for missed or late payments
- Interest surcharge for missed repayments - this means an additional amount of interest will be charged on the amount unpaid
- Completion fee for ownership of the goods to pass to you – sometimes you have to pay a *balloon payment* much higher than your usual monthly payments
- Repossession charges - you could be charged for repossession costs or for failure to take reasonable care
- Rescheduling charge - if your lender agrees to change the loan terms

Any *balloon payment* charged on a hire purchase loan has the effect of postponing part of the costs until after the loan. This means that in the earlier months and years, you are paying less off your loan than you would for a bank or a credit union loan. You have to pay the balloon payment to clear the loan and to become the legal owner.

What must be in a HP agreement contract?

A hire purchase agreement is drawn up and signed by you (the hirer) and on behalf of the owner (the finance company). If there is a retailer involved, for example, a garage, it also signs the agreement and supplies the items in question.

The hire purchase must include:

- The item covered under the agreement, for example, a car or computer.
- The cash price of the item.
- The hire purchase price. This is the total amount you will pay over the life of the loan. The hire purchase price is the monthly payment or instalment multiplied by the number of instalments which you have to make.
- The amount of each installment you have to pay. Sometimes the final instalment is much larger than all the others (a *balloon payment*).
- The date you must pay each instalment.
- The names and addresses of all the parties to the agreement.
- A statement that you have the right to withdraw from the agreement within 10 days of receiving a copy of the agreement. This is known as a cooling off period. Often you are asked to give away this right by signing a waiver. You do not have to sign this waiver.
- A statement that you must tell the owner (finance company) of the locations of the item.
- The words "Hire Purchase Agreement" which must be stated clearly and in a prominent place on the agreement form.
- The fees, charges, and penalties that apply.
- The Annual Percentage Rate (APR) charged (for agreements made since 16 May 2022).

Unless all of these requirements are contained in the agreement, the agreement may not be legally enforceable.

You should try to take some time to read all the terms of the agreement and make sure you understand these fully before you sign up.

Can I end a HP agreement?

You can end the agreement at any time by giving notice in writing to the owner of the goods (the finance company). This is a legal right under the Consumer Credit Act 1995. You should be aware that breaking a hire purchase contract before its normal end date usually involves penalties.

You have two options:

1. **Buy the item earlier than planned.** You can own the item by paying the difference between the amount already paid and the total hire purchase price. There is usually a reduction on the overall amount due as you are paying the loan off earlier than planned. This reduction is calculated using a recognised formula for early loan repayments. However, the amount of any reduction is relatively small.
2. **Return the item to the owner and pay half the amount of the total hire purchase price** (if the total of instalments already paid have not reached that amount). This is called *the half-rule*. You do not have to pay half the hire purchase price immediately.

If you have not paid half the hire purchase price you can still return the item. However, you will still owe the difference between the payments you have made and half the hire purchase price.

If you have already paid more than half of the total hire purchase price, you will owe any arrears due up to the date of termination.

You may have to pay damages for failure to take reasonable care. The finance company may issue a notice of costs, but you should try to get your own estimate before handing back the goods. Take photographs of the goods before handing them over. If you sign any paperwork, make sure it says 'Statutory Termination' and not 'Voluntary Surrender' because different calculations will usually be used to work out how much you owe.

The CCPC has more information about the half rule and cancelling a HP agreement.

Ending an agreement using the half rule may not always be the best solution. Contact MABS to talk through your options.

Can the owner take back the item?

The finance company can only repossess (take back) the item under certain conditions:

- If you are in arrears and have not yet paid off one-third of the total hire purchase cost, the owner can repossess the goods at any time without taking legal action against you. They must send you a *default notice* first and give you at least 21 days to put things right, unless a court says they do not have to.
- If you have paid one-third or more off the total hire purchase cost, the owner cannot repossess the goods without taking legal action.

Any deposit that you pay at the start of the agreement or the value of any trade-in, for example, is taken into account in calculating one third of the cost.

If this one-third rule is breached by the owner, you are entitled to end the agreement and can ask for a refund of all payments made. The CCPC has more information about the one-third rule (pdf) and you can contact MABS for free and confidential advice.

What happens if the item is faulty or damaged?

Anything you buy under a hire purchase agreement must comply with the Sale of Goods and Supply of Services Act 1980 and be:

- Of merchantable quality - this means of reasonable and acceptable standard, taking into account other factors such as durability and price
- Fit for the purpose you bought it for
- As described, whether the description is part of the advertising or wrapping, on a label or something said by the salesperson

If the item hired under a HP agreement are or become faulty, both the retailer and the owner (finance company) are responsible. You can claim against either party in this situation. You cannot claim against the manufacturer of the item.

If you return the defective item, you are entitled to a refund of any instalments paid. Consumer rights in this situation are the same as if the item was bought outright.

A guarantee under a hire purchase agreement applies in the same way as if items were bought outright. The manufacturer makes the guarantee. If there is a fault with the item, you can choose to have the item repaired under the guarantee or to seek a full refund or exchange from the owner.

Under a hire purchase agreement, you have a duty to take reasonable care of the hired item. If you damage the item and return them to the owner or finance company, they can send you a bill for repairs.

Making a complaint about a HP agreement

If you would like independent information or help in understanding any of the terms and conditions of your hire purchase (or any other loan) contract, you can contact the CCPC. If you would like free and confidential advice about HP debt, contact MABS.

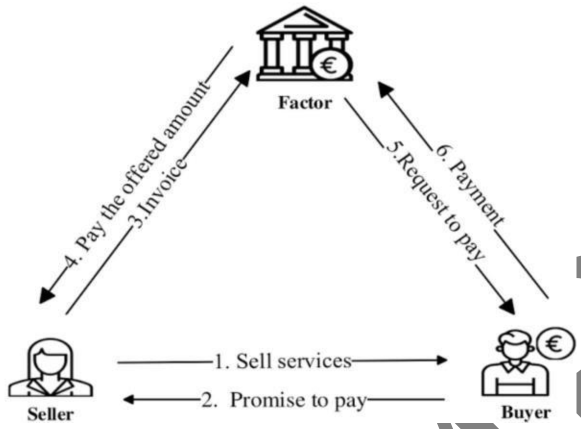
If you want to make a complaint about a HP agreement, you should first address your complaint to the finance company. If you are not satisfied with their response, you can make a formal complaint to the Financial Services and Pensions Ombudsman (FSPO). The FPSO has the power to award you compensation where your rights have been breached, or where there is evidence of unfair treatment.

You do not have to accept the solution recommended by the Ombudsman. You are entitled to look for redress by taking legal action against the finance company.

Factoring:

What is Factoring?
Factoring is a financial technique where a specialized firm (factor) purchases from the client's accounts receivables that result from the sales of goods or services to customers. In this way,

the customer of the client firm becomes the debtor of the factor and has to fulfil its obligations towards the factor directly.
The factoring agreement usually assumes that the whole credit risks as well as the collection of the accounts are taken by the factor. Factoring offers enterprises, particularly small and medium ones, a means of financing their need for working capital, but also an instrument of collection of receivables and default risk hedging.



Characteristics of Factoring

- Factor provides finance for the supplier, including loans and advance payments.
- 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 less costly source of finance compared to other sources of short term borrowings.
- Factoring receivables is an ideal financial solution for new and emerging firms without strong financials. This is because creditworthiness 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 for factoring. But the factoring companies usually carry out credit risk analysis before entering into the agreement.
- Factoring is a method of off balance sheet financing.

Mechanism of Factoring

In a factoring arrangement, there are three parties directly involved namely; the one who sells the invoice (client), the debtor (customer of the seller), and the factor (financial organization).

- Seller of the product or service provider who originates the invoice is called Client and generally is a business firm.

- Debtors or customers of the client are the recipient of the invoice for the goods or services rendered. They promise to pay the balance within the agreed payment terms. They owe the money for the value of goods and services bought from the seller.

- Assignee (the factoring company) or factor is the service provider who purchases the invoice and gives advance payment to the business firm.

Advantages of Factoring

Following are some of the advantages of factoring services:

- **Substitute for market credit**: Factoring has an important role in working capital finance. Factoring substitutes bank borrowings and supplements the market credit or suppliers' credit. It replaces high-cost bank loans.

- **Time Savings**: Factoring can save time and effort to the company that would otherwise be spent on collecting from customers. That energy can be redirected to other business-building activities, like sales, marketing and client development.

- **No Collateral Required**: Unlike traditional bank loans, factoring doesn't require you to risk your home or other property as collateral.

- **Reduction in operating cycle time**: With factoring, the average receivables collection period is reduced substantially and as a consequence the total operating cycle time of the client is reduced. This contributes to efficient working capital.

- **Liquidity**: Factoring helps the company to raise cash, even up to 90% of the invoice value immediately after the sale. This builds the liquidity position of the client.

- **Advisory Services**: Factoring institutions offer a variety of advisory services to its clients including credit assessment for its overseas buyers.

Disadvantages of Factoring

Factoring provides a pool of benefits to a business by providing immediate cash for your account receivables. However, it also has some drawbacks that need to be considered before deciding on factoring services. Some of these drawbacks are as follows:

- **High cost**: Factoring provides immediate access to cash, but this will come at a higher price than loans. Factoring companies usually keep between 1% and 4% of a receivable as their fee. In addition to this, they also charge an interest on the cash advance provided.

- **Adverse relationship with customers**: Factoring companies are usually more aggressive while collecting debts, and this may upset the customer and lead to nil or decreased sales by the customers.

- **Potential change in business practices**: A Factor may insist on changing business strategies, and interfere in the working of the business and may even recommend cutting off certain customers. This highlights the necessity of ensuring that the businessman chooses to work with such a lender who understands his business and is interested in its growth.

Types of Factoring

There are a number of types of factoring in both theory and practice. Various types of factoring depend on the relation between the main parties in the factoring operation.

It also depends on the specific features in the factoring agreement. The most common feature of practically all the factoring transactions is collection of Recourse and Non-recourse Factoring

- In recourse factoring, the factor does not assume the credit risk (risk of non-payment by the debtors). In other words, if the receivables become bad, i.e. if the customer does not pay on maturity, risk of bad receivables remains with the seller, and the factor does not assume any risk associated with the receivables.

  The factor provides the service of receivables collection, but does not cover the risk of the buyer failing to pay the debt. The factor can recover the funds from the seller (client) in the case of such default. The seller assumes the risks associated with the credit and the buyer's creditworthiness.

  The factor charges the seller for the management of receivables and debt collection services, while also charging interest on the amount advanced to the client (seller).

- On the other hand, in non-recourse factoring, the factor assumes the risk of non-payment by the client's customers. The factor cannot demand any outstanding amount from the client (seller).

  The commission or fees charged for non-recourse factoring services are higher than for recourse factoring. The factor assumes the risk of non-payment on maturity and consequently takes an additional fee called a del credere commission.

Domestic and Export Factoring

- In domestic factoring three parties are involved (the seller, the buyer, and the factor), while in export factoring there are four (the seller, the buyer, the domestic factor, and the factor abroad). In domestic factoring, the factor mediates between the seller and the buyer. All three parties are located in the same country.

- Export factoring is similar to domestic factoring, except there are four parties involved. There are consequently two factors involved in the transaction, and it is referred to as the two-factor system of factoring.

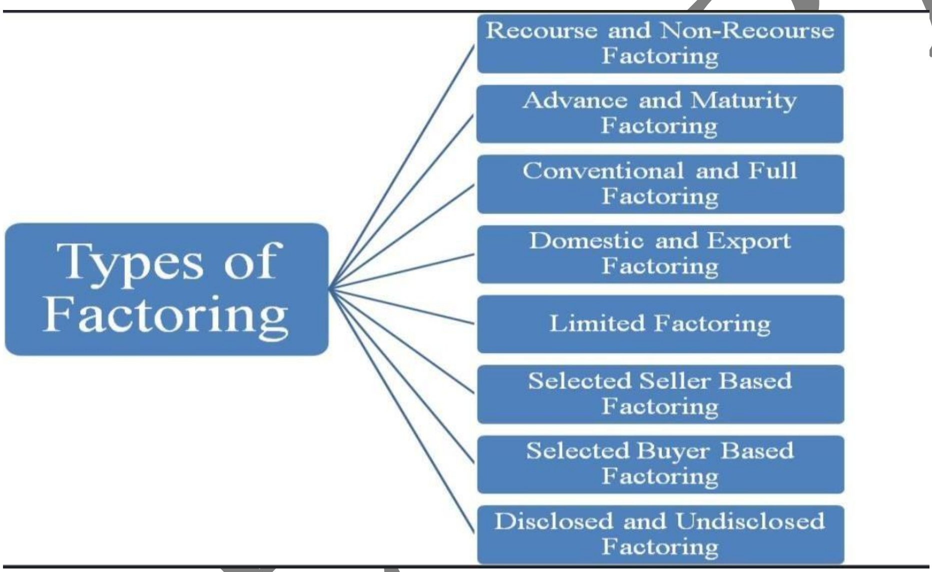
Conventional or Full Factoring

- In full factoring, the factor performs almost all services of collection of receivables, maintenance of sales ledger, credit collection, credit control and credit insurance.

  The factor also fixes up a draw limit based on the bills outstanding maturity-wise and takes the corresponding risk of default or credit risk and the factor will have claims on the debtor as also the client creditor.

  Full factoring is also known as Old Line Factoring. In India, factoring agencies like SBI Factors are doing full factoring for good companies with recourse.

receivables and administration of sale ledger.



What Is Forfaiting?

Forfaiting is a means of financing that enables exporters to receive immediate cash by selling their medium and long-term receivables—the amount an importer owes the exporter—at a discount through an intermediary. The exporter eliminates risk by making the sale without recourse. It has no liability regarding the importer's possible default on the receivables.

The forfaiter is the individual or entity that purchases the receivables. The importer then pays the amount of the receivables to the forfaiter. A forfaiter is typically a bank or a financial firm that specializes in export financing.

How Forfaiting Works

A forfaiter's purchase of the receivables expedites payment and cash flow for the exporter. The importer's bank typically guarantees the amount.

The purchase also eliminates the credit risk involved in a credit sale to an importer. Forfaiting facilitates the transaction for an importer that cannot afford to pay in full for goods upon delivery.

The importer's receivables convert into a debt instrument that it can freely trade on a secondary market. The receivables are typically in the form of unconditional bills of exchange or promissory notes that are legally enforceable, thus providing security for the forfaiter or a subsequent purchaser of the debt.

These debt instruments have a range of maturities from as short as one month to as long as 10 years. Most maturities fall between one and three years from the time of sale.

WHAT IS BILL DISCOUNTING?

Bill Discounting is one such option, which allows a business to get quick payment for their work and meet their operating expenses without having to depend on any external agency to provide the funds.

Bill Discounting, also called Invoice Discounting, is a trading activity where a seller sells some goods or services to a buyer. The buyer has to make the payment as per the agreed credit period. Now, if the buyer needs money before that, he can approach a bank or some NBFC and 'sell' that invoice to them. The financial institution gets the invoice verified by the buyer and then makes payment to the seller on their behalf. However, they make some deductions, called 'discounts', as their commission.

So, in a way, the seller gets a discounted payment for their bill. This way, they can run their business operations, and buyers get an extended credit period. On the due date, the seller makes the payment to the financial institution, which completes the cycle for that particular invoice. Since the seller gets payment on a 'discount', this transaction is called Bill Discounting.

FEATURES OF BILL DISCOUNTING:

1. **Evaluating the seller and buyer:** Before approving the bill discounting, the bank or NBFC first checks the seller's reputation and the buyer's creditworthiness. This is done to ensure that the buyer does not default on making the payment to the bank.
2. **Making instant cash available for the buyer:** It is the most salient feature of bill discounting. The bank or NBFC purchases the invoice and immediately pays after discounting the bill. This makes life easy for the seller. They get an immediate payment and do not need to wait for the buyer to pay the bill.
3. **Discount Charge:** The difference margin between the face value of the invoice and the amount approved and disbursed by the bank is called the discount. This discount is calculated on the maturity value at a certain percentage per annum.
4. **Maturity:** The maturity date of a bill means the date on which payment of the invoice is due. The average maturity period is 30, 60, 90, or 120 days.

BILL DISCOUNTING RATE OF INTEREST:

Most banks and NBFCs do not have a fixed interest rate for discounting bills. Any financial institution considers several factors before deciding on the discount, which may vary from customer to customer.

The various factors that go into consideration for deciding the discounting rate are:

- Financial history and credit score of the seller
- Years of being in the business
- Business volume
- Credit-worthiness of the buyer
- Stability of the business and industry

Role of Institutional Players: Many Institutions such as State Bank of India, Canara Bank, Indian Overseas Bank, Syndicate Bank, in fact all Public Sector Banks are Proving Housing finance at attractive and affordable rates. Apart from these banks, HDFC, LIC, PNBHF, ICICI, are very active in this area. All these institutions offer a number of Home Loan Products to its clientele that include plot purchase Management of Financial Services 7A.3 Housing Finance loan, house construction loans, home / flat purchase loan, house improvement loan and extension loan. Royal Sundaram Home Loans is very Popular in southern India. 7a.3 Tenure of Loan: The tenure of loan depends upon age, need of the customer, purpose of loan, repayment capacity, tenure of service etc. On an average house owners are taking the loan for 15 years on Equated Monthly Installments (EMI) Cost of Loan: All the housing finance Institutions charge processing and administration fee which is linked to the amount of loan from customers. The quantum of charges affects the cost of loan to be borne by the customer.

Housing finance System:

The implementation of Housing finance Policies presupposes efficient institutional arrangements. Although there were a large number of agencies providing direct finance to individuals for house construction, there was no well established finance system till the mid eighties in as much as it had not been integrated with the main financial system of the country. The establishment of the National Housing Bank (NHB), a fully owned subsidiary of the Reserve Bank of India as an apex Institution was the end of the fulfillment of a long overdue need of the Housing finance Industry in India. The system has also been characterised by the emergence of several specialised financial institutions that have considerably strengthened the organization of the Housing finance system in the country. At present, there are about 320 Housing finance companies of which 26 are registered with the NHB and which account 98 percent of the Total Housing Loan disbursed. Following are the main agencies operating in our country.

a) Central and State Governments: Till the mid eighties the responsibility to provide Housing finance rested by and large with the Government. The Central and State Governments indirectly support the housing building effort. The Union Government has introduced from time to time various social housing schemes. The role of the Central Government against these schemes is confined to laying down broad principles providing necessary advice and rendering financial assistance in the shape of loans and subsidies to the State Governments and Union Territories.

The Central Government has set up the Housing and Urban Development Corporation (HUDCO) to finance and undertake housing and Urban development Programmes Development of land for satellite towns besides setting up of a building materials industry. The Central Government provides necessary fulcrum to the HUDCO and guarantees the Bonds issued by it. Apart from this the Central Government and respective State Governments provide house building advances to their employees. The responsibility of the Central Government is to evolve the policies and the respective State Governments are the real implementers.

Housing and Urban Development Corporation (HUDCO):

HUDCO was established on 25th April 1970 as a fully owned Government of India enterprise with the following objectives. a) To provide long-term finance for construction of houses for the residential purposes or finance or undertake housing and urban development programmes in the country. b) To finance or undertake the establishment of New Satellite Towns. c) To finance or undertake the establishment of the building materials industries. d) Administer the monies received from the government of India and other such grants for purposes of financing or undertaking housing and urban development programmes. e) To subscribe to the debentures and bonds to be issued by the State Housing Boards, Improvement Trusts, Development Authorities and so on specially for the purpose of financing housing and urban development programmes.

Venture capital financing

Venture capital financing is a type of funding by venture capital. It is private equity capital that can be provided at various stages or funding rounds. Common funding rounds include early-stage seed funding in high-potential, growth companies (startup companies) and growth funding (also referred to as series A). Funding is provided in the interest of generating a return on investment or ROI through an eventual exit through a share sale to an investment body, another trading company or to the general public via an Initial public offering (IPO). Venture Capital can be made in four methods: 1) Equity Financing; 2) Conditional Loan; 3) Income Note; and 4) Participating Debenture.

Process

There are five common stages of venture capital financing:

1. Pre-seed funding | Concept stage
2. Seed stage
3. Post-seed / pre-third stage | Bridge round
4. Third stage | Series A
5. Fourth stage | Series B
6. Pre-initial public offering (IPO) stage

The number and type of stages may be extended by the venture capital firm if it deems necessary; this is common. This may happen if the venture does not perform as expected due to bad management or market conditions (see: Dot com boom). The following schematics shown here are called the process data models. All activities that find a place in the venture capital financing process are displayed at the left side of the model. Each box stands for a stage of the process and each stage has a number of activities. At the right side, there are concepts. Concepts are visible products/data gathered at each activity. This diagram is according to the modeling technique developed by Sjaak Brinkkemper of the University of Utrecht in the Netherlands.

Seed stage

This is where the seed funding takes place. It is considered as the setup stage where a person or a venture approaches an angel investor or an investor in a venture capital firm for funding for their idea/product. During this stage, the person or venture has to convince the investor why the idea/product is worthwhile. The investor will investigate the technical and economical feasibility (feasibility study) of the idea. In some cases, there is some sort of prototype of the idea/product that is not fully developed or tested.

If the idea is not feasible at this stage, and the investor does not see any potential in the idea/product, the investor will not consider financing the idea. However, if the idea/product is not directly feasible, but part of the idea is worthy of further investigation, the investor may invest some time and money in it for further investigation.

Risk

At this stage, the risk of losing the investment is tremendously high, because there are so many uncertain factors. The market research may reveal that there is no demand for the product or service, or it may reveal that there are already established companies serving this demand. Research by J.C. Ruhnka and J.E. Young shows that the risk of the venture capital firm losing its investment is around 66.2% and the causation of major risk by stage of development is 72% .[5] The Harvard report[1] by William R. Kerr, Josh Lerner, and Antoinette Schoar, however, shows evidence that angel-funded startup companies are less likely to fail than companies that rely on other forms of initial financing.

Start-up stage

If the idea/product/process is qualified for further investigation and/or investment, the process will go to the second stage; this is also called the start-up stage. A business plan is presented by the attendant of the venture to the venture capital firm. A management team is being formed to run the venture. If the company has a board of directors, representatives from the venture capital firms will take seats at the board of directors.

While the organisation is being set up, the idea/product gets its form. The prototype is being developed and fully tested. In some cases, clients are being attracted for initial sales. The management-team establishes a feasible production line to produce the product. The venture capital firm monitors the feasibility of the product and the capability of the management-team from the board of directors.

To prove that the assumptions of the investors are correct about the investment, the venture capital firm wants to see the results of market research to see if there are sufficient consumers to buy their product (market size). They also want to create a realistic forecast of the investment needed to push the venture into the next stage. If at this stage, the venture capital firm is not satisfied about the progress or market research results, the venture capital firm may stop their funding and the venture will have to search for another investor(s). When there is dissatisfaction and it is related to management performance, the investor may recommend replacing all or part of the management team.

Third stage

At this stage, we presume that the idea has been transformed into a product and is being produced and sold. This is the first encounter with the rest of the market, the competitors. The venture is trying to squeeze between the rest and it tries to get some market share from the competitors. This is one of the main goals at this stage. Another important point is the cost. The venture is trying to minimize their losses in order to reach the break-even. The management team has to handle this decisively. The venture capital firm monitors the management capability of the team. This consists of how the management team manages the development process of the product and how they react to competition.

If at this stage the management team has proven their capability of standing against the competition, the venture capital firm will probably give a go for the next stage. However, if the management team lacks in managing the company or does not succeed in competing with the competitors, the venture capital firm may suggest restructuring of the management team and extend the stage by redoing the stage again. In case the venture is doing tremendously bad whether it is caused by the management team or from competition, the investor will cut the funding.

Fourth stage

This stage is seen as the expansion/maturity phase of the previous stage. The venture tries to expand the market share they gained in the previous stage. This can be done by selling more of the product and having a good marketing campaign. Also, the venture will have to see whether it is possible to cut down their production cost or restructure the internal process. This can become more visible by doing a SWOT analysis. It is used to figure out the strength, weakness, opportunity and the threat the venture is facing and how to deal with it. Apart from expanding, the venture also starts to investigate follow-up products and services. In some cases, the venture also investigates how to expand the life-cycle of the existing product/service.

At this stage the venture capital firm monitors the objectives already mentioned in the second stage and also the new objective mentioned at this stage. The venture capital firm will evaluate if the management team has made the expected cost reduction. They will also examine how the venture competes against the competitors. The new developed follow-up product will be evaluated to determine its potential.

Bridge/pre-IPO stage

In general, this is the last stage of the venture capital financing process. The main goal of this stage is for the venture to go public so that investors can exit the venture with a profit commensurate with the risk they have taken.

At this stage, the venture achieves a certain amount of market share. This gives the venture some opportunities, for example:

- Merger with other companies
- Keeping new competitors away from the market
- Eliminate competitors

Internally, the venture has to examine the product's market position and, if possible, reposition it to attract new Market segmentation. This is also the phase to introduce the follow-up product/services to attract new clients and markets. Ventures have occasionally made a very successful initial market impact and been able to move from the third stage directly to the exit stage. In these cases, however, it is unlikely that they will achieve the benchmarks set by the venture capital firm.

Fee-Based Advisory services:

What Is a Fee-Based Investment?

A fee-based investment is a product that is recommended by a financial planner whose compensation includes a sales commission paid by the investment provider in addition to the fees paid by the client. Fee-based investments may be offered by investment companies, banks, or other financial institutions.

A fee-only investment is recommended by a financial planner who is solely compensated in fees paid by the client.

Confusingly, a "fee-based advisor" may charge clients an annual flat percentage for all financial services. This advisor may or may not receive commissions for recommending fee-based investments.

How Fee-Based Investments Work

There is a wide range of fee-based investments from annuities to mutual funds, stocks, bonds, and other securities. In any case, the advisor whose client buys the asset is paid a commission from the sponsoring company for selling it.

The term fee-based is also used to describe a hybrid advisor, who charges fees to certain clients and earns commissions by selling products to others.

About Investment Fees

An investment advisor may charge a fee for each service or a fixed annual percentage of the assets under management (AUM). Annual fees average 1% to 3% and cover most or all of the services a client receives from the advisor.

Stockbroking:

Stockbroking is a service which gives retail and institutional investors the opportunity to buy and sell equities.

Stockbrokers will trade shares both on exchange and over-the-counter, dependent on where they can find the best price and liquidity. Stock exchanges place strict regulations on who can trade shares directly on their books, which is why most individual investors hoping to trade shares will do so via a stockbroker.

Typically, a stockbroking firm will charge commission on the trades it makes on a client’s behalf, or a fee for retaining its services.

There are several different services a stockbroker can provide:

- **Execution-only** stockbrokers will complete orders on your behalf, but do not offer any advice

- **Advisory** stockbrokers will offer advice on where to trade, but only trade on orders submitted by you

- **Discretionary** stockbrokers will trade on your behalf, executing trades without your input.

Credit Rating:

What Is a Credit Rating?

The term credit rating refers to a quantified assessment of a borrower's creditworthiness in general terms or with respect to a particular debt or financial obligation. A credit rating can be assigned to any entity that seeks to borrow money—an individual, a corporation, a state or provincial authority, or a sovereign government.

Individual credit scores are calculated by credit bureaus such as Experian, Equifax, and TransUnion on a three-digit numerical scale using a form of Fair Isaac Corporation (FICO) credit scoring. Credit ratings for companies and governments are calculated by a credit rating agency such as S&P Global, Moody’s, or Fitch Ratings. These rating agencies are paid by the entity seeking a credit rating for itself or one of its debt issues.

A Brief History of Credit Ratings

Moody’s issued publicly available credit ratings for bonds in 1909, and other agencies followed suit in the decades after.4 These ratings didn’t have a profound effect on the market until 1936 when a new rule was passed that prohibited banks from investing in speculative bonds—that is, bonds with low credit ratings.

The aim was to avoid the risk of default, which could lead to financial losses. This practice was quickly adopted by other companies and financial institutions. Soon enough, relying on credit ratings became the norm.5

The global credit rating industry is highly concentrated, with three agencies controlling nearly the entire market: Moody’s, S&P Global, and Fitch Ratings.

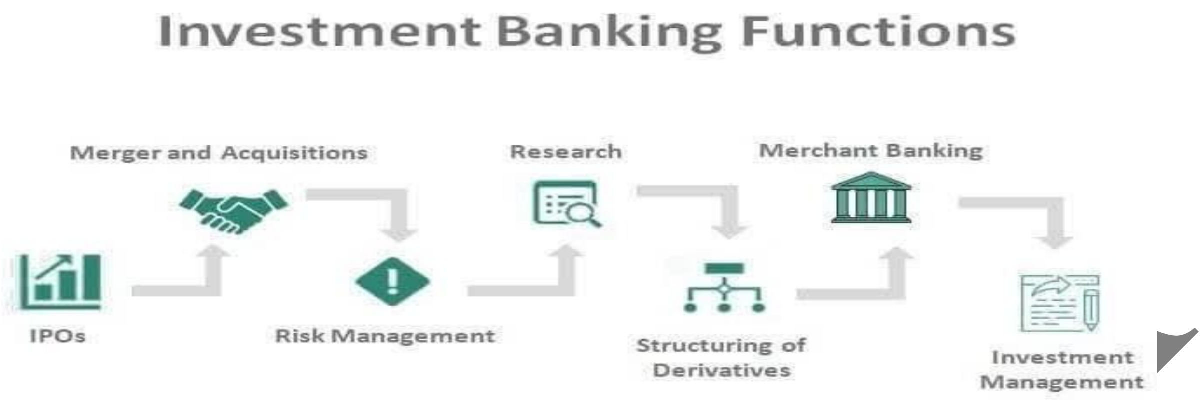
MODULE-5

INVESTMENT BANKING

What is investment banking and its functions?

Definition: Investment banking is **a special segment of banking operation that helps individuals or organisations raise capital and provide financial consultancy services to them**. They act as intermediaries between security issuers and investors and help new firms to go public.

Functions of Investment Banking:



1 .IPOs:

This investment banking function, i.e., **IPO** is an initial public offering wherein a company hires an investment bank to issue an IPO.
Below are the steps followed by a company for its IPO:-

- Before the issuance of an IPO , companies hire an investment bank. This bank is chosen based on different criteria like market reputation, industrial experience, quality of research and distribution channels, etc.
- Selected banks do **underwriting** where it acts as a broker between investors and issuing companies.
- The investment bank works out the financial details of the IPO in the underwriting agreement.
- Post that company files the registration statement along with the underwriting agreement with SEC.
- Post-approval of IPO by SEC underwriter and issuing company decide **offer price** and several shares be sold.
- After issuance, the bank carries out aftermarket stabilization in which that bank analyzes aftermarket stabilization and creates a market for the stock.
- The final stage is a transition to market competition. After 25 days, the bank provides an estimate regarding the valuation and earnings of the issuing company.

2 – Merger and Acquisitions

- There are two types of roles in M & M&A of an investment bank: seller representation and buyer representation.
- A critical role in M&A is the valuation of a company. The bank calculates the actual value of a company.
- Investment bank builds its strategy for M&A of two companies.

- The investment bank also does financial provisioning for a company as M & M&A companies will need lots of funds. It helps a company in raising funds for M&A.
- The main role is to issue new securities to the market.

3 – Risk Management

From the name itself, Risk Management is clear that its risk management involves a continuous process as capital is involved. It set a limit to avoid loss in trade. Investment banks help a company in the following ways:-

- Investment banks help a company manage **financial risk** in terms of currency, loans, liquidity, etc.
- This bank helps a company to recognize the loss area.
- This **credit risk**-control credit risk investment spreads out counterparties, and banks choose stock exchanges for trading.
- There are different risks like **business risk**, investment risk, legal & compliance risk, and operational risk, internally controlled by an investment bank.

Investment banks do risk management at every level as it highlights the risks and how they can be handled.

4 – Research

This equity research investment banking function is one of the most important investment banking functions. This research helps provide a rating to the company to help investors decide on investment. Research reports tell whether to buy, sell, or hold based on a company's rating. Through this, one can know the worthiness of the company. Research is done by analyzing and comparing various company reports and performance reports. Investment banks' primary work is research, and these researches are of multiple types like **equity research**, fixed income research, macroeconomic research, qualitative research, etc. Investment banks share these reports with clients, which helps an investor to generate profit through **trading and sales**

5 – Structuring of Derivatives

Derivatives products offer a high rate of return and a good margin; hence, many risks are involved. Investment banks prepare these derivatives with a strategy based on single and multiple securities.

For this Investment banking function, i.e., structuring derivatives, investment banks need a strong technical team working on such a complex structure of derivatives.

Investment banks design securities with different derivatives options. The main reason to design such a product is to attract investors and increase the **profit margin**.

6 – Merchant Banking

This investment banking function is one of the personal activities of the investment bank where the bank also does consultancy for their clients. It acts as a financial engineer for business. They provide consultancy in financial, marketing, legal, and managerial matters.

7 – Investment management

This investment banking function is a core job of an investment bank to guide the investor to purchase, manage his portfolio, and trade various securities. Investment banks prepare reports based on company performance, and through this investment bank decides on financial securities. Investment advice is based on the client's objective, **risk appetite**, investment amount, and period. Based on the customer segment, investment management is divided into Private clients, Private wealth management, wealth management. Here, an investment bank manages a portfolio of customers and provides tips to investors on whether to sell stocks, buy stocks, or hold stocks.

Investment Banking Activities:

Investment banking is a type of banking that organizes large, complex financial transactions such as mergers or initial public offering (IPO) underwriting. These banks may raise money for companies in a variety of ways, including underwriting the issuance of new securities for a corporation, municipality, or other institution. They may manage a corporation's IPO. Investment banks also provide advice in mergers, acquisitions, and reorganizations.

- In essence, investment bankers are experts who have their fingers on the pulse of the current investment climate. They help their clients navigate the complex world of hInvestment banking deals primarily with raising money for companies, governments, and other entities.
- Investment banking activities include underwriting new debt and equity securities for all types of corporations.
- Investment banks will also facilitate mergers and acquisitions, reorganizations, and broker trades for institutions and private investors.
- Investment bankers work with corporations, governments, and other groups. They plan and manage the financial aspects of large projects.
- Investment banks were legally separated from other types of commercial banks in the United States from 1933 to 1999, when the Glass-Steagall Act that segregated them was repealed.

Underwriting:

What Is Underwriting?

Underwriting is the process through which an individual or institution takes on financial risk for a fee. This risk most typically involves loans, insurance, or investments. The term underwriter originated from the practice of having each risk-taker write their name under the total amount of risk they were willing to accept for a specified premium.

Although the mechanics have changed over time, underwriting continues today as a key function in the financial world.

- Underwriting is the process through which an individual or institution takes on financial risk for a fee.
- Underwriters assess the degree of risk of insurers' business.
- Underwriting helps to set fair borrowing rates for loans, establish appropriate premiums, and create a market for securities by accurately pricing investment risk.
- Underwriting ensures that a company filing for an IPO will raise the capital needed and provide the underwriters with a premium or profit for their services.
- Investors benefit from the vetting process of underwriting grants by helping them make informed investment decisions.

How Underwriting Works

Underwriting involves conducting research and assessing the degree of risk each applicant or entity brings to the table before assuming that risk. This check helps to set fair borrowing rates for loans, establish appropriate premiums to adequately cover the true cost of insuring policyholders, and create a market for securities by accurately pricing investment risk. If the risk is deemed too high, an underwriter may refuse coverage.

What Information Do Underwriters Look at?:

Whether they are lending money or providing insurance, underwriters examine the financials of each applicant to determine how much risk they are taking on and the likelihood of losing money. This is generally done by comparison to historical data: If applicants with a similar risk profile tend to default X% of the time, then the premiums or interest rate will be priced at a rate that assumes an X% probability of default.

Underwriters for personal loans and insurance will look at the available data of the applicant. For loans, they might examine the borrower's income, employment status, and credit history. They will also assess the value of any assets that are used for collateral. For life insurance, they might also look at their medical history, including risk factors such as smoking or drinking.

Bankers to an Issue:

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investors in respect of issues of capital and refund of application money.

Registration

To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI. The SEBI grants registration on the basis of all the activities relating to banker to an issue in particular with reference to the following requirements: a) The applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities, b) The applicant/any of the directors of the applicant is not involved in any litigation connected with the securities market/has not been convicted of any economic offence; c) The applicant is a scheduled bank and d) Grant of a certificate is in the interest of the investors. A banker to an issue can apply for the renewal of his registration three months before the expiry of the certificate. Every banker to an issue had to pay to the SEBI an annual fee of Rs.2.5 lakhs for the first two years from the date of initial registration, and Rs.1 lakh for the third year to keep his registration in force. The renewal fee to be paid by him annually for the first two years was Rs.1 lakh and Rs.20,000 for the third year. Since 1999, schedule of fee is Rs.5 lakhs as initial registration fee and Rs.2.5 lakhs renewal fee every three years from the fourth year from the date of initial registrations. Non-payment of the prescribed fee may lead to the suspension of the registration certificate.

General Obligations and Responsibilities Furnish INFORMATION
When required, a banker to an issue has to furnish to the SEBI the following information; a) The number of issues for which he was engaged as a banker to an issue; b) The number of application/details of the application money received, c) The dates on which applications from investors were forwarded to the issuing company /registrar to an issue; d) The dates/amount of refund to the investors.

DBA 1724 Books of Account/Record/Documents

A banker to an issue is required to maintain books of accounts/records/documents for a minimum period of three years in respect of, inter-alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company/registrar to the issue and dates and amounts of refund money to investors.

Disciplinary Action by the RBI

If the RBI takes any disciplinary action against a banker to an issue in relation to issue payment, the latter should immediately inform the SEBI. If the banker is prohibited from carrying on his activities as a result of the disciplinary action, the SEBI registration is automatically deemed as suspended/cancelled.

Debenture Trustee:

Debenture Trustee is a liaison between the issuer company and the debenture holders, who hold the secured property on behalf of the issuer company, which is mortgaged in favor of the debenture trustee for protecting the interest of debenture holders.

Debenture Trustee is an entity that secures any issue of debentures of a body corporate for the benefit of investors.

Debenture Trustee plays a very important role in the NCD issue by safeguarding the interest of debenture holders and acting as an intermediary between the issuer company and the debenture holders.

As per the provisions of the companies act, the appointment of a debenture trustee is mandatory in case of debentures/bonds with maturity beyond 18 months, irrespective of whether debentures/bonds are secured or not. However, the issue of debentures/bonds with a maturity of 18 months or less are exempt from the requirement of a debenture trustee.

Debenture Trustee Regulations SEBI

The SEBI (Debenture Trustees) Regulation, 1993 governs the Debenture Trustee and provides for all the required details for Debenture Trustee from eligibility criteria to responsibilities of a Debenture Trustee along with the procedure for action in case of default.

Debenture Trustee Appointment / Eligibility Criteria

To act as a debenture trustee, the entity should either be:

- A scheduled bank carrying on commercial activity; or
- A public financial institution; or
- An insurance company; or
- A body corporate.

The entity should be registered with SEBI to act as a debenture trustee.

The entity should be an independent body from the issuer company and should in no way be related to the company.

The *principal officer* overseeing the activities of the debenture trustee should **NOT** be:

- A beneficial share owner of the issuer company, or
- A promoter, director or key management personnel or employee of the issuer company or its holding, subsidiary or associate company.

Debenture Trustee Role and Responsibilities

- To protect the interest of the debenture holders.
- To call for and keep a periodic check on the reports of the issuer company.
- To take possession of the trust property by provisions of the trust deed.
- To take appropriate measures to protect the interest of the debenture holders in case of any breach of the trust deed or law.
- To ensure that the debentures have been converted or redeemed as per the provisions and conditions under which they are offered to debenture holders.
- To enforce security in the interest of the debenture holders in case of any default by moving to assets for collection of debt.
- To ensure at all times that the property charged to the debenture is free from any other claim except those specifically agreed with the debenture holder and that the property is available and adequate to discharge the interest and the principal amount payable in respect of the debentures.
- To exercise due diligence to ensure that the issuer entity is compliant with provisions of the Companies Act, the listing agreement of the stock exchange, or the trust deed.
- To inform the Board immediately in case of any breach of trust deed or provision of law.
- To appoint a nominee director on the board of issuer entity when required. A nominee director can be appointed in case of below happenings:
  - Two consecutive defaults in payment of interest to debenture holder or
  - Default in the creation of security for debentures or
  - Default in the redemption of debt.

Portfolio Manager:

What Is a Portfolio Manager?

A portfolio manager is a person or group of people responsible for investing a mutual, exchange traded or closed-end fund's assets, implementing its investment strategy, and managing day-to-day portfolio trading. A portfolio manager is one of the most important factors to consider when looking at fund investing. Portfolio management can be active or passive, and historical performance records indicate that only a minority of active fund managers consistently beat the market.

Understanding a Portfolio Manager's Role.

A portfolio manager holds great influence on a fund, no matter if that fund is a closed or open mutual fund, hedge fund, venture capital fund or exchange-traded fund. The manager of the fund's portfolio will directly affect the overall returns of the fund. Portfolio managers are thus usually experienced investors, brokers, or traders, with strong backgrounds in financial management and track records of sustained success.

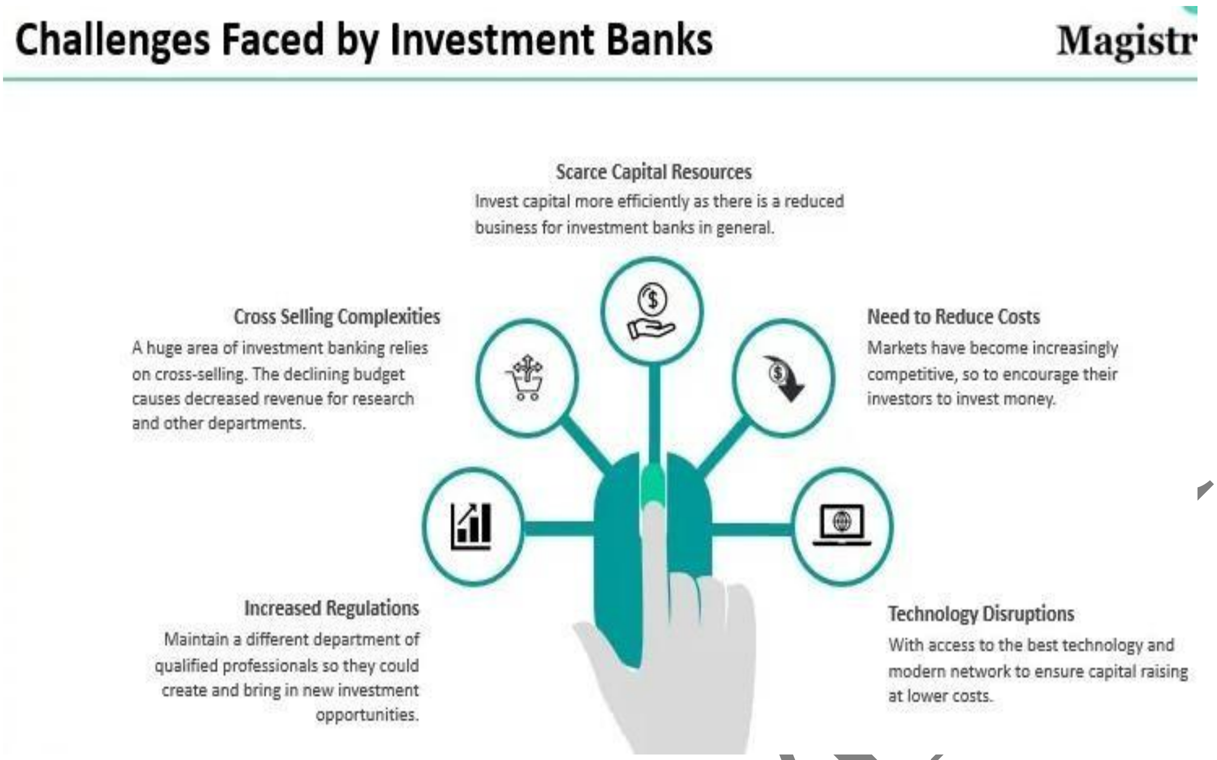
A portfolio manager, regardless of background, is either an active or passive manager. If a manager takes a passive approach, their investment strategy mirrors a specific market index. Using that market index as a benchmark is extremely important since an investor should expect to see similar returns over the long term.

Conversely, a manager can take an active approach to investing, which means that they attempt to consistently beat average market returns. In this scenario, the portfolio manager themselves is extremely important, since their investment style directly results in the fund's returns. Potential investors should look at an active fund's marketing material for more information on the investment approach.

Characteristics of a Good Portfolio Manager
Regardless of the investment approach, all portfolio managers need to have very specific qualities in order to be successful. The first is ideation. If the portfolio manager is active, then the ability to have original investment insight is paramount. With over 7,000 active funds to choose from, active investors need to be smart about where they look.2 If the manager takes a passive approach, the originating insight comes in the form of the market index they've decided to mirror. Passive managers must make smart choices about the index.

Challenges to Investment Bankers:

The modern investment banking industry faces several challenges. Some of these challenges have been listed down in this article.



Scarce Capital Resources: The coronavirus pandemic has created recessions and depressions all over the world. As a result, in almost all markets, individuals, as well as companies, are not very comfortable investing their money. They would rather hold on to their money for some time rather than invest it in the short run. This has created a world where capital resources are scarce. The job of investment bankers is to allocate capital resources efficiently. If there are fewer capital resources to be allocated, then there is a reduced business for the investment bankers in general. This has become a challenge for the entire industry since they are looking at a prolonged recession.

Need to Reduce Costs: Markets all over the world have become increasingly competitive. As a result, the prices of goods and services are going lower. This is having a ripple effect on the finance industry as well. Companies are facing shrinking margins, and hence the cost of capital is going down as well. The problem is that the investors are already afraid to invest money. In such a scenario, they expect more compensation in order to induce them to invest. However, the market is actually reducing the interest rates as well as the costs of equity. Hence, investment bankers are not able to reconcile the needs of corporations as well as the investors, which is creating a challenge for them as far as effective intermediation is concerned.

Increased Regulations: The investment banking industry was blamed for the mortgage crisis of 2008. This is the reason why heavy regulations have since been put into place. The new structured financial products which are created and sold by the finance industry are heavily scrutinized by the regulatory agencies. This creates limits on the operations of the investment banks. The number of new types of securities being created and traded by investment banks has seen a reduction post 2008. Adhering to the regulations adds to the costs at investment banks. Separate departments have to be maintained in order to ensure that the bank is compliant with the changing regulations. This also makes the services of investment banks more expensive and hence less competitive.

Technology Disruption: The rapid advances in technology have drastically changed every industry in the world. The world of investment banking is no exception, either. Over a period of years, an entirely new industry called fintech has emerged. The fintech industry is all about leveraging the use of financial technology in order to provide the same financial services for a lower price. For instance, modern fintech companies have shown that they can be more effective at raising capital as compared to investment banks. Their access to the best technology and modern network ensures that they are able to raise capital at a lower cost. Also, they have a wider reach as compared to traditional investment banks.

There are more examples where the use of technology has been more effective than investment banks. For instance, in the recent past, Bitcoin has been effectively used in order to raise capital from foreign sources. The transaction costs in the case of Bitcoin have been remarkably less as compared to the transaction costs related to normal cross border financing. If the investment banking industry does not imbibe the use of technology with immediate effect, it will soon be at the risk of becoming obsolete, thanks to fintech.

Difficulty in Cross-Selling: Investment banks have traditionally relied a lot on cross-selling. For instance, if a client comes in looking for mergers and acquisitions advisory, investment banks are often able to convince them to avail services such as issue management, capital structure advisory, and so on. There is no doubt about the fact that investment banks generate value for clients while doing these activities. However, in the current scenario, corporations have limited budgets. This means that they have clearly instructed their finance departments to limit the number of services that they avail. This decreased budget is translating into decreased revenue for research and other departments in investment banks, which are heavily dependent upon cross-selling revenue. Companies are preferring to avail services from specialists instead of buying all the services from an investment bank for a bundled price.

The bottom line is that investment banking is not in its heydays anymore. Over the years, the negative publicity, as well as the number of challenges, have increased manifold. No government wants to be seen as being sympathetic towards Wall Street. Hence, it is unlikely that the industry will receive any help from the government, either. The industry needs a transformation wherein the best practices from the previous models are merged with the best practices of modern technology.