II SEM BCOM STUDY MATERIAL

INDIAN FINANCIAL SYSTEM

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Unit 1 – FINANCIAL SYSTEM

Financial System: It is a set of all financial institution which facilitates financial transactions in financial markets. It brings under its fold the financial markets and the financial institution which support the system.

Classification of Indian Financial system/ Components of Indian Financial System

Financial Institution **Financial Markets** **Financial Instruments** **Financial Services**

Banking Institution **Non banking** **Money Mkt** **Cap Mkt** **Type** **Term** **Fund Based** **Fee based**

Commercial Banks co Operative Banks Call Money Mkt Primary Sec Short Leasing

Treasury Bills Secondary Sec Medium Hire Purchase

Public sector banks Commercial Bills Derivative Instruments Long Factoring

Private Sector Banks

RRBs Merchant Banking

Foreign Banks Organised Unorganised Credit Rating

Mergers

Financial Markets : Financial markets can be referred to those centres arrangements which facilitate buying and selling of financial assets, claims and services. Organised Market consists of :

1. **Capital market**
2. **Money market**

Capital Market: is a market for financial assets which have long or indefinite maturity, it generally deals with securities which have maturity period above a year. It is divided into 3 categories:

1. Industrial securities
2. Government securities
3. Long term securities

1. Industrial Securities: It is market for industrial securities namely equity shares, pref shares, debentures or bonds. It is a market where industries raise capital or debt by issuing appropriate instruments; it is divided into 2 types:

I. Primary or New issue Market

II. Secondary or Stock exchange1

I. Securities which are issued to the public for first time. In this market borrowers exchange or offer new financial securities for a long term funds ,hence it is capital formation.

a) Public issue: Raising capital by new companies is through sale of securities to the public.
b) Rights issue: It is raised by existing co for additional capital to existing share holders.
c) Pvt Placements: It is a way of selling securities privately to a small group of investors.

1. Secondary market: It is a market for secondary sale of securities, such shares quoted in the stock exchange market. It provides continuous and regular market for buying and selling. It is also called as stock market.

Functions of Primary Market

1. Transfer of resources
2. Investigative services /Origination provide information based on market analysis.
3. Advisory services
4. Guarantee/Underwriting
5. Distribution
6. Aids in expansion/diversification/modernisation of existing units
7. Major players of primary market are merchant bankers, underwriting, brokers, advt agencies etc

Significance of Primary Markets

1. Provides avenue for investment
2. Mobilisation of savings
3. Channelizes savings for productive use
4. Source of large supply of funds
5. Enables rapid industrial growth
6. Source for expansions and up gradation.

Functions of Secondary market

1. Liquidity of securities as securities can be converted into cash readily
2. Marketability of securities as it facilitates buying and selling of securities.
3. Safety of funds belonging to investors
4. Availability of long term funds
5. Flow of funds to profitable projects.
6. Motivation for improved performance by companies to get competitive edge.
7. Promotion of investment opportunities.

8. Availability of business information.
9. Reflection of business cycle.
10. Promotes marketing of new issues by companies.

2. Govt securities market: It is a market where Govt securities are traded.Govt securities have both long and short term securities. Long term is traded in stock exchange and short term in Money market. Securities are issued by central, State and Semi Govt Organisation such as city corporation, Port trusts, State electricity board etc, they also carry the benefit of Tax exemption.
3. Long term Loans Market: Commercial banks and Development Banks play a significant role by supplying long term loans to corporate.
   a) Term loan market
   b) Mortgage Market
   c) Financial guarantee Market

Money Market: It is a market for dealing financial assets and securities which have a maturity period of up to one year. It is a market for short term funds.

a) Call money Market: it is a market for extremely short period of time like one day to fourteen days, it is highly liquid. They are associated with stock exchange and interest rates vary from day to day and even hour to hour.
b) Commercial Bills Market: It is a market for bills of exchange arising out of genuine trade transaction Where commercial bill is a draft accompanied by a bill of lading and which is drawn by a seller in one country against a buyer in another on account of goods sold by the latter, It is customary for the drawer of a commercial bill to make it payable to himself.
c) Treasury bill Market: It is a market for Treasury bill which has short term maturity. It is a promissory note or a finance bill issued by Government. It is highly liquid as its repayment is guaranteed.
d) Short term loan market: Short term loans are given to corporate customers.

Difference between Money market and Capital Market.

Money market	**Capital Market**
1) It is for period less than a year	Its period exceed s one year
2) It supplies funds for current Business operations, working Capital requirements	It finances fixed capital requirement of Trade and commerce
3) The instruments used in Money Market are bills of exchange, Treasury Bills	This market deals with instruments like shares, bonds etc
4) Each single Money Market is of smaller Large amount e.g. TB of 1 lakh	Each single instrument is of a value e.g., one equity share – Rs 10
5) Central and commercial banks are The major players in this market	Development banks and insurance cos are major players in this market

6) Money Market instruments do not Have secondary markets	Capital market instruments generally have secondary market
7) Transaction happens without broker	Transaction happens only through an Authorised dealer

Importance of Capital Markets

1. Productive use of economy"s savings
2. Provides incentives for saving
3. Facilitates capital formation
4. Increases production and productivity
5. Stabilises value of securities
6. Enables technological up gradation

Importance of Money Market

1. Development of Trade and Industry
2. Development of Capital market
3. Enables smooth functioning of commercial banks
4. Effective functioning of central bank
5. Formulation of suitable Monetary policy
6. Non inflammatory source of Finance to government.

Important Questions

Section A

1. What is Financial system
2. What are financial institutions?
3. What are financial markets?
4. What is primary or new issue market?
5. What is secondary market?
6. What is money market?
7. What is plastic money?
8. What is call money market?
9. What is Repos?
10. What is Capital Market?
11. What are commercial papers?
12. What are commercial Bills?
13. Who is a speculator?

1. Explain constituents of financial system?
2. State difference between Money market and capital market.
3. State difference between Primary market and Secondary market.
4. State features of developed money market.

1. Explain role and importance of Indian financial system.
2. What are the components of money market?
3. What is capital market? Discuss importance of capital market.

CHAPTER-2 FINANCIAL INSTITUTIONS

FINANCIAL INSTITUTIONS

Development Banks State level Institution Other Institution

IDBI,IFCI, IIBI, SIDBI, ICICI

SFCS/SIDCS ECGE/DICGE

Investment Institution

UTI, LIC, GIC

Refinance Institution
NABARD, NHB

Refinance institutions

NABARD\NHB
FII- Financial institutions of investors
SIDBI-small industries development bank of India
UTI-unit trust of India
LIC- life insurance Company
GIC-general insurance corporate
IIBI-industrial investment bank of India
NABARD-national bank of agriculture and rural development
NHB-national housing bank
SFCS-state financial corporations
SIDS-state industrial development corporation
IFCI-industrial Finance Corporation of India
TFCI-tourism financial corporation of India
TDICI-technology development and information
BIFR-board of industrial and financial reconstruction
ICICI- Industrial credit and Investment Corporation of India

Meaning of financial institution:

A financial institution is basically a term lending institution .It is generally called as development bank. A development bank may be defined as a financial institutions concerned with providing all types of financial assistance to business units in form of loans, underwriting, investment, guarantee operations and promotional activities for economic development and industrial development. Financial institution includes banks, credit unions, AMC, building societies and stock brokerages etc. These are the institutions which are responsible in distributing financial resources in a planned way to potential users. Investing money on behalf of the client is another of the varieties of functions of financial institutions. The primary functions of financial institutions are:

1. Accepting deposits
2. Providing commercial Loans
3. Providing real estate Loans
4. Providing Mortgage Loans
5. Issuing Share certificate

Types of financial institutions

I. Banking Institutions
II. Non Banking Financial Institutions

I. <u>Banking Institutions :</u> they are governed by RBI, and come under Banking Regulations Act 1949.

1. Savings banks: savings bank is established to create saving habit among the people especially salaried people. At present most of the Commercial banks carry the function of savings bank.
2. Commercial Banks: are established with a objective to help businessmen.
3. Industrial Banks/Development Banks: they collect cash by issuing shares and debentures providing loan to industries. the main objective of these banks is to provide long term loans for expansion and modernisation of industries.
4. Land Mortgage bank/Land development Banks/Agricultural Banks: Finances Agricultural sector for lesser interest.
5. Indigenous Banks: includes Money lenders, sahukars lending their own funds to needy persons for interest.
6. Central Bank: Every country of the World has a Central Bank eg. RBI in India, Federal Reserve in USA, Bank of England in UK.
7. Co-operative banks: are registered under Cooperative societies Act in 1912, give credit facilities to small farmers, SSI etc.
8. RRBs: they are established with the objective to develop Rural Economy.
9. Foreign Bank: they are foreign banks working in India, these banks are concerned with financing corporate clients and specialised in Internationalised Banks.

II. Non Banking Financial Institutions: These are institutions which do not have full license or is not supervised by a National or International Banking Regulatory Agency. They facilitate bank related financial services such as investment, risk pooling, market brokering etc .They may be categorised into 2 groups:

A) Organised Financial Institution

i) Development Finance Institution: they are the organised financial institution

Eg. IDBI, ICICI, IFCI , SFC, SIDC etc

ii) Investment Institution: These mobilise savings of Public at large through various schemes eg. LIC , GIC, UTI

B) Unorganised Financial Institution: These include hire purchase and consumer finance companies, leasing companies, credit rating agencies, merchant banking companies, housing finance companies.

Role of development banks:

1. Promotional financing.

2. Project promotion.

3. Entrepreneurial guidance and development.

4. Refinance facilities.

5. Technical assistance.

6. Housing finance and finance to small scale industries.

7. Rural development and agricultural development.

8. Innovation financial services:

Financial services like leasing, merchant banking, venture capital financing seed capital and assistance, research and development services and mutual fund services.

9. Co-ordinating functions.

10. Rendering advice of the govt.

INDUSTRIAL DEVELOPMENT BANK OF INDIA:

It was established in July 1964 under IDBI act

ROLE OF IDBI:

1. It is the principle financial institution for coordinating in conformity with national priorities, promoting or developing industries.

2. Providing Technical and Administrative for promotion from a management or expansion of industry.

3. Undertaking market and investment research and surveys.

FUNCTIONS OF IDBI:

It falls into the following groups.

1. Direct assistance.

2. Indirect assistance.

3. Promotional activities.

DIRECT ASSISTANCE:

It further divided into.

1. Term loan term loans are provided for period ranging between 10 to 12years.

2. Underwriting of securities.

3. Direct subscription of shares and debentures.

4. Guarantees loan and deferred payments

5. Venture capital.

6. Equipment leasing.

2. INDIRECT ASSISTANCE:

a) Refinancing of industrial loans.

b) Resource support to financial institutions.

c) Rediscounting of bills.

3 PROMOTIONAL ACTIVITES:

a) Assistances to backward areas:

Direct assistance like giving concessions in the form of interest longer repayment period, longer grace period and lower margin requirement

b) Refinance:

Refinance facilities are provided at concessional rate of interest to SFCs for financing small and medium industries

NON-FINANCE MEASURES:

By conducting survey of the backward areas for assessing the industrial potential and identifying the projects for resource availability and infrastructure facilities

B) ASSISTANCE TO SMALL SCALE INDUSTRIES:

1>Refinancing ton state levels institutions which in turn finance small scale industries and small road transport operators.

2> Constriction to the shares and bonds issued by SFC‟S

3>Refinancing to SFC"S to cover loans granted to industrial estates.

3> DEVELOPMENT TO ENTHROPRENORS

1) Seed capital assistance through SFC"S and SID"S.

2)100% refinance is respect of composite loans preparation of project profile.

Assistance to state level institutions in the formulation and implementation of training programs for entrepreneur.

INDUSTRIAL FINANCE CORPORATION OF INDIA

It was set up in 1948 under IFCI act its main object is to finance medium and long term period.

FUNTIONS OF IFCI

1. Granting of loans both in Rs and foreign currencies.

2. Raised by industrial concern in the capital market.

3. Underwriting of shares debentures and bonds.

4. Direct subscription to the shares and debentures of public Ltd companies.

1) To provide financial assistance in short medium and long term.

2) To provide consultancy and merchant banking.

3) To carry on business of leasing and higher purchase.

4) To undertake activities like wear housing, factoring custodial services, etc.

5) To set up investment company.

6) To deal, transact buy and sell foreign currencies.

7) Act"s as trustee, executor, administrator, treasurer and trust.

STATE FINANCIAL CORPORATIONS (SFC'S):

It was established under SFC act 1951.

TYPES OF ASSISTANCE OR FUNCTIONS

1) Granting loans for a period not excluding 20 years.

2) Under writing the issue of stock under shares, bonds and debentures.

3) Granting deferred payment.

4) Granting loans raised by industrial concerns in the capital market.

UNIT TRUST OF INDIA

It was established in the year 1964.

The primary objectives of UTI:

1. To encourage and pool the savings of middle and low income and enable them to share the benefits and prosperity of industrial development in the country.

1) Selling the units of UTI among many investors in different parts of the country.

2) Paying dividends to the unit holders.

3) Investing the sale proceeds of the units in the corporate securities.

4) Buy or sell or deal in foreign exchange dealings.

5) Acquire and sell immovable property.

6) Open an a/c or enter in to agency agreement with the bank incorporated outside INDIA.

7) Extent port folio management service two persons residing outside INDIA.

8) Provide merchant banking and investment advisory service.

Advantages of the Units UTI

1) Investments in units are safe because the risk is spread over a wide range of securities which reduces the risk to the unit holders considerably.

3) The units are highly liquid.

LIFE INSURANCE CORPORATION OF INDIA:

It was established on 1st SEP 1956.LIC provides funds to industries in 3 forms.

1) Direct lending to the industry.

2) Purchase of shares and debentures in the stock market.

3) Subscription to the shares and bonds of financial institutions.

The LIC finance industry indirectly by investing in the shares and bonds state level financial institutions like IDBI, ICICI, IFCI, etc;

General Insurance Corporation of India (GIC)

It was established in the year 1972.The subsidiaries of GIC are:

1) National Insurance Company

2) New assurance.

3) The oriential fire general insurance company.

5) The united INDIA fire and general insurance company Ltd.

THE FUNCTIONS OF GIC ARE:

1) Financial assistance:

It is further divided into direct assistance.

a) Granting loans.

b) Under writing.

c) Direct subscription of shares and debentures.

2) Purpose wise assistance.

a) New projects.

B) Expansion and diversification.

c) Modernization, rehabilitation and balancing equipment.

d) Working capital including the working of the assistance concerns.

3) Sector wise assistance.

Assistance to public sector is wide when compared to corporative sector.

ICICI (Industrial Credit and Investment Corporation of India):

It was established in the year 1955 objectives.

1) To stimulate the promotion of new industries.

2) To assist the expansion modernization of existing industries.

3) To furnish technical and managerial aid so has to increase production and employment opportunity.

FUNCTIONS:

1) Long term and medium term loan are in rupees &foreign currency.

2) Participation in equity capital and in debenture.

3) Undergoing of shares and debentures.

4) Guarantee the suppliers of equipment & foreign loaners.

The main objectives of ICICI can be classified as follows

1) Lending operations.

a) Project finance.

b) Guarantee facility to

customers. c) Direct subscription.

d) Leasing.

e) Deferred capital.

f) Technology finance.

>Subsidiaries.

ICICI has set up the following subsidiaries since

1999. *ICICI –Securities & finance company Ltd.

*ICICI –Brokerage service Ltd.

*ICICI-Asset management Ltd.

*ICICI-Personnel finance services Ltd.

CAPITAL MARKET OPERATION.

ICICI has promoted no institutions to promote capital & money market and also for finance growth of technology.

SPONSORING INSTITUTIONS:

IIBI [industrial investment bank of INDIA]

It was setup in INDIA in the year 1997.

The main objects of IIBI are.

- Project finance.
- Merchant banking services.
- Silk unit portfolio.
- Relationship with BIRF [Board for industrial financial reconstruction]

EXIM BANK [Export import bank of India]

It was set up on January 1st 1982.The main functions of EXIM bank are.

- Financing of exports & imports of goods & services of not only India but also third country.
- Financing of joint venture in foreign countries.
- Financing of export &import of machinery & equipment on lease basis.
- Undertaking merchant banking function.
- Providing technical administrative & finance assistance in EXIM trade.
- Technology &consultancy service.
- Relending facility to bank overseas.
- Line of credit to foreign govt.

NATIONAL HOUSING BANK [NHB]

It was set up on July 9th 1988. The main functions are:

1) Promote & develop specialized housing finance institutions for Mobilizing resources & supply credit for house construction.

2) To provide guarantee & underwriting facilities to housing finance institution.

3) To coordinate working of all agencies connected with housing.

4) To provide refinance facilities to housing finance institutions &scheduled banks.

SIDC [STATE INDUSTRIEDS DEVELOPMENT CORPORATION]

It was set up in the year 1956.

Functions of SIDC ARE:

- Formation of industrial estates.
- Marketing assistance.
- Hire purchase and equipment leasing scheme.
- Industrial development in backward areas.
- Export house.

MUTUAL FUNDS

DEFINITION:

The fund established in the form of a trust by sponsor to raise money by the trustees through sale of units to the public under one or more schemes for investing in securities in accordance with the regulation.

Mutual fund collects the saving from investors, invested in Government, in the corporate

Securities & income through dividends & interest decides capital gain.

SCOPE OF MUTUAL FUNDS

1) Organization of the fund lies in the hands of investors.

2) Investment in left in the hands of progression who earn fee for services.

3) It is invested in a portfolio of marketable securities.

4) It is represented in units.

5) It is invested in specific sector like IT sectors, fertilizer industries, ETC.

Types of Funds/ Classification of Mutual funds

Mutual Funds

On the basis of execution & Operation On the basis of yield and investment pattern

Close ended Open ended Income Fund Growth fund Balance fund Specialised fund

Money Market MF Taxation Fund

Closed-End Fund: a fixed number of nonredeemable shares are sold through an initial offering and are then traded in the OTC market. Its duration is fixed, once subscription reaches the pre determined level , the entry of investors is closed. After expiry of fixed period, the entire corpus is disinvested and proceeds are distributed to various unit holders in proportion to their holding. Price for the shares is determined by supply and demand forces.

Open-End Fund: investors may buy or redeem shares at any point, where the price is determined by the net asset value of the fund.

Net Asset Value (NAV)

Definition: Total value of the mutual fund"s stocks, bonds, cash, and other assets minus any liabilities such as accrued fees, divided by the number of shares outstanding.

On the basis of Yield and Investment Pattern

Mutual fund further classified on the basis of yield and investment pattern. they are:•Income Fund

Growth Fund

Balance Fund

Specialised Fund

Money Market

Taxation Fund

Income funds

Income funds main aims at generating and distributing regular income to the subscribers (Investors) on a periodical basis. It concentrates more on distribution of regular income in terms dividend. Income funds are suitable to the old and retired people who may not have any regular income.

Growth funds

Growth funds concentrate mainly on long run gains. It means capital appreciation. They do not offer regular income and they aim at capital appreciation in the long run. Hence, they have been explained as “Nest Eggs” investments.

Balanced funds

Balance funds also known as “Income-cum-Growth” Fund. It is a combination of both income and growth funds. It aims at distributing regular income as well as capital appreciation. This is achieved by balancing the investments between the high growth equity shares and also the fixed income earning securities.

Specialised funds

A large number of specialised funds are in existence abroad. They offer special schemes so as to meet the specific needs of specific categories of people like pensioners, widows etc. For instance, Japan Fund, South Korea Fund etc.

Money Market mutual funds

Money markets mutual funds are basically open ended mutual funds are as such they have all the features of the open ended fund. But they investment in highly liquid and safe securities like commercial paper, banker‟s acceptance, certificates of deposits, Treasury bills etc.

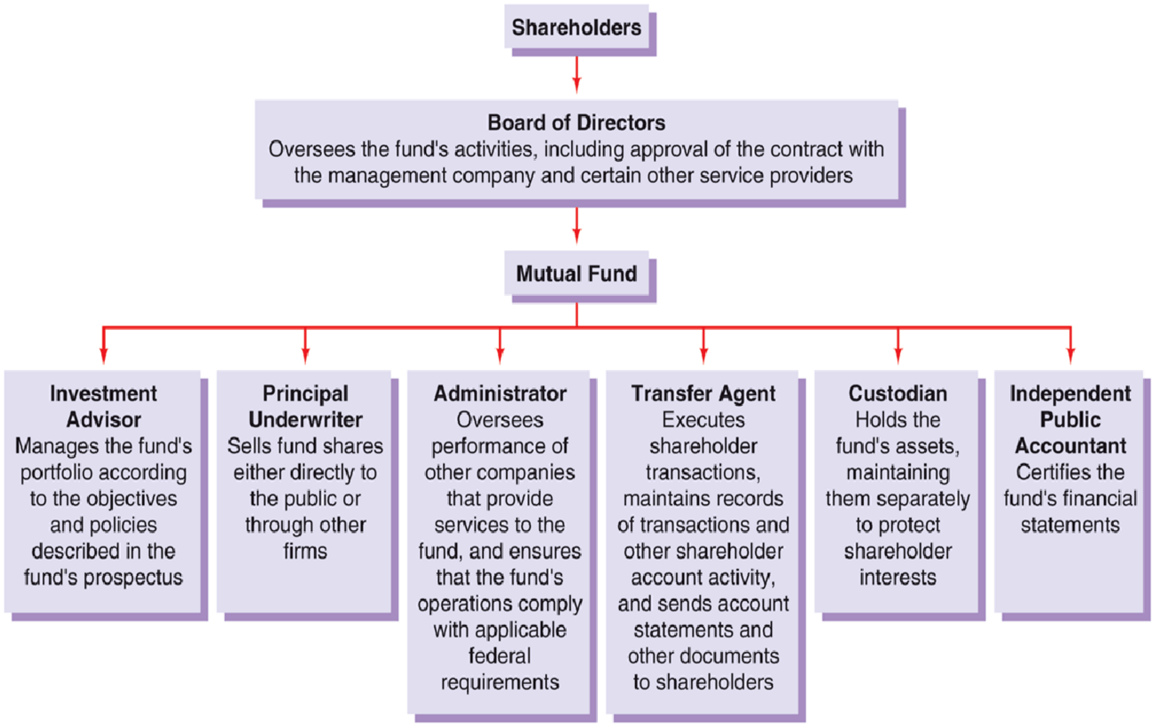
Taxation funds

A taxation fund is basically a growth oriented fund. But, it offers tax rebates to the investors either in the domestic or foreign capital market. It suitable to salaried people who want to enjoy tax rebates particularly during the month of February and March.

Index funds

Index fund refers to those funds where the portfolios are designed in such a way that they reflect the composition of some broad based market index. This is done by holding securities in the same proportion as they index it

Mutual Fund Structure:
the Organization



Asset Management Company

- An AMC is a legal entity formed by the sponsor to run a mutual fund.
- It is the AMC that employs fund managers and analysts and other personnel.

It is the AMC that handles all operational matters of a mutual fund – from launching schemes to managing them to interacting with the investors.

Important Questions

Section A

1. What are RRBs?
2. Define EXIM Bank.
3. State any 2 objectives of Exim Bank.
4. What is foreign bank?
5. Expand IDBI and ICICI.
6. Expand AMC
7. What are Mutual Funds?
8. State any 4 types of Mutual funds.

Section B

1. State objectives and functions of IDBI.
2. State Merchant banking functions.
3. State the functions of Mutual Funds.
4. What are the advantages of Mutual Funds?
5. What are the objectives and functions of EXIM Bank.
6. What are the functions and problems of SFCs?

Section C

1. What are Mutual Funds? Explain the different types of Mutual Funds.
2. Write a note on LIC.
3. What are the objectives and functions of EXIM BANK?

Unit 3: Commercial Banking System

DEFINITION: Commercial Banks are the oldest banking institutions in the organized sector. They constitute the predominant segment of the banking system in India. They cater to the needs of the TRADE, COMMERCE, INDUSTRIES, AGRICULTURE, SMALL BUSINESS, TRANSPORT and OTHER ACTIVITIES with a wide network of branches throughout the country.

FUNCTIONS OF COMMERCIAL BANKS

Primary Functions

1. **Acceptance of Deposits**
2. **Creation of credit**
3. **Lending of funds**
4. **Use of cheque system**
5. **Remittance of funds**

Secondary function

Agency Functions

- **Payment and collection function**
- **purchase and sale of securities**
- **Acting as Executor, Administrator & trustee**
- **Acting as Attorney**

General utility Functions

1. **Safe custody function**
2. **Issue of letter of credit**
3. **Travelers' cheque**
4. **Merchant Banking**
5. **Foreign Exchange function**
6. **Leasing**
7. **Housing Finance**
8. **Underwriting of shares**
9. **Tax consultancy**
10. **Credit cards**
11. **Gift Cheques**
12. **Consultancy functions**
13. **Teller System**
14. **Factoring**

Primary function:

1. Acceptance of deposits – Accepts deposits from different customers like individuals, household, corporate and non corporate customers. The different sources of funds are
   a) Deposits of various types of funds
   b) Borrowing of RBI
   c) Borrowing from Financial institutions
   d) Borrowing from fellow bankers
   e) Borrowing from abroad

   Types of deposits are:

   i) Current Deposit A/c
   ii) Fixed deposit A/c
   iii) Savings Deposit A/c
   iv) Recurring deposit A/c
2. Creation of Credit: When commercial bank advances loan to its customers, liquid cash will not be lent instead it opens an account in the borrowers name and credits the same, such deposits is credit creation.
3. Lending of funds: Banks earn income in the form of interest through granting loans and advances of various forms. There are two types of loans:
   1. Secured loans: It means loans made on the securities of tangible assets like building; machinery etc. It is further divided into primary and collateral security.
      a) Primary security is the security deposited by borrower himself to cover for the loan
      b) Collateral security is used in two senses it denotes any type of security on which the creditor has a personal right of action on the debtor in respect of the advance.
   2. Unsecured loans: they are the loans extended by the bank without accepting any security from the borrower, this type of loan is extended for business men having a long term healthy relationship with the bank.

   Forms of Advances:

   1. Loans: banker advances a lump sum money for a certain period at an agreed rate of interest
   2. Cash: it is an arrangement which the customer is allowed to borrow money up to a certain limit. Interest is charged on the amount withdrawn, entire amount need not be withdrawn it could be withdrawn partially.
   3. Overdraft: It is an arrangement between the banker and his customer by which the latter is allowed to withdraw over and above his credit balance in current account up to an agreed limit.
   4. Bills discounted and purchased: banks grant advances to their customers by discounting bills of exchange. The amount after deducting the interest from the instrument is credited in the account of the customer. In this form of lending the interest is received by the banker in advance.
   5. Use of cheque system: banks have introduced an in expensive medium of exchange which is as good as money, called cheque; commercial banks perform a unique function of issuing and collecting cheque.

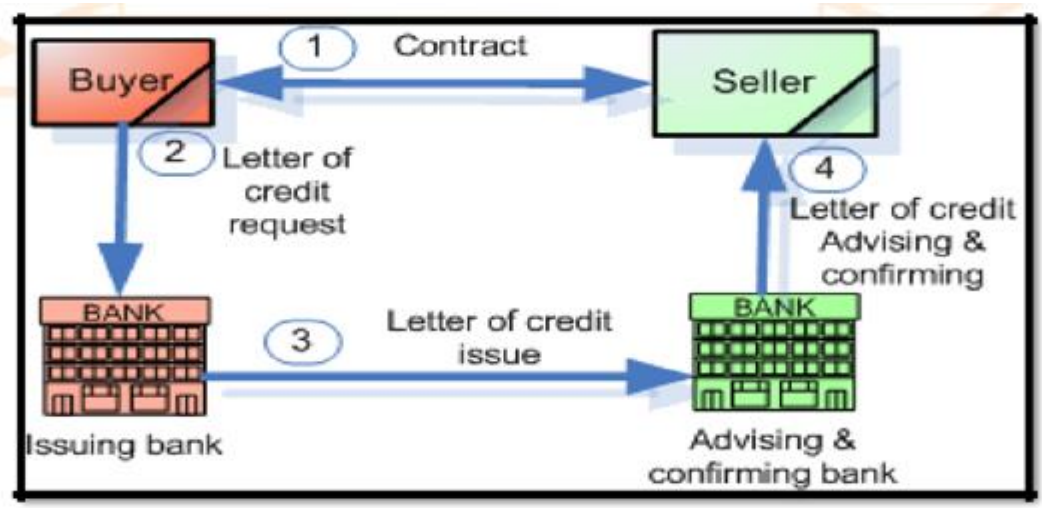
6. Remittance of funds: banks help their customers in transferring funds from one place to another by issuing bank drafts, mail transfers, and telegraphic transfers on nominal commission charges.

Secondary functions of commercial banks:

A) Agency functions:
   i) Payment and collection of dividends, salaries, subscription etc.
   ii) Purchase and sale of securities
   iii) Acting as executor, administrator and trustee
   iv) Acting as attorney
B) Miscellaneous Functions:
   SAFE CUSTODY OF VALUABLES:
   Banks accept shares, debentures, bonds, FDR (FIXED DEPOSIT RECEIPT), deed of property, life insurance policy, sealed boxes containing valuables such as jewelers from customers for safe custody as they are equipped with strong, fireproof and theft proof rooms for safe maintenance of valuables. The banker either accepts valuables for safe custody or hires out, safe deposit volts or lockers to customers.

   LETTER OF CREDIT:
   Assumes great importance in International trade. As it assures payment to exporter soon after the importer receives the goods or documents of title to goods. It is sort of guarantee to the exporter that his draft will be honored by a specified bank up to a certain amount as per specified terms. There are 4 important parties:

   > Applicant (importer)
   > Issuing Bank (importers bank)
   > Beneficiary (exporter)
   > AdvisoryBank(exporters country)



TRAVELLERS CHEQUE:

It is useful to persons who frequently travel within the country or abroad. It has the following features:

< it can be purchased by anyone in different denominations.

example: Rs.50, Rs.100, Rs.500.

< purchaser has to deposit money with the issuing bank equivalent to the amount of travellers cheque he intends to pay.

< purchaser has to sign at the time of purchase on travellers cheque issued.

< there is no expiry of travellers cheque and is issued in single name only.

< it is usually encashable only at the branches of the issuing bank or at the banks which have tie-up with the issuing bank.

Merchant Banking: It offers a wide range of services like financial, technical and managerial services. Following are the main services:

> All aspects of project counseling such as pre-investment and feasibility studies to identify a project.

> Liaison work to help entrepreneurs to obtain various government consent such as letter of intent, industrial license, etc.

> Preparation of project reports.

> Assistance in formulation of financial plan.

> assisting in companies with respect to amalgamation mergers and takeovers.

> To assist in widening and strengthening of business.

> To help in locating and evaluating new market.

MERCHANT BANKING is a combination of banking and consultancy services. It provides consultancy, to its clients, for financial, marketing, managerial and legal matters. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange. It helps to raise or collect finance and to expand and modernize the business.

FUNCTION:

- PROJECT COUNSELLING: Guidance in relation to project viability, preparation of project report obtaining various government approvals, capital structuring, risk identification and the like.
- CREDIT SYNDICATION SERVICE: Preparation of application, syndication of loans, post-sanction negotiations, completing legal documentation and arranging working capital loan.
- MANAGEMENT OF PUBLIC ISSUES: Advise on a sound capital structure, appointment of bankers/ brokers to the issue, selection of issue house/ registration of issue, action plan and budget for the issues, drafting of prospectus, assistance in

advertising campaign, coordination with underwriters, brokers and bankers and stock exchanges and stock exchange and compliance with post- issue activities.

- SICK INDUSTRIAL UNITS: Counseling for rejuvenating sick units-exploring possibilities of mergers/ amalgamations- capital restricting- evolving rehabilitation programmed- assistance in getting approval of BIFR- monitoring the implementation scheme.

- OTHER SERVICES: advising NRI on suitable investment opportunities- negotiations of foreign collaborations- portfolio fund management- advice on leasing finance- arrangement for venture capital.

Dealing in FOREX Business:

1. Guarantee for deferred payment.

2. Export financing is provided by the bank both for pre and post shipment at lesser interest rate.

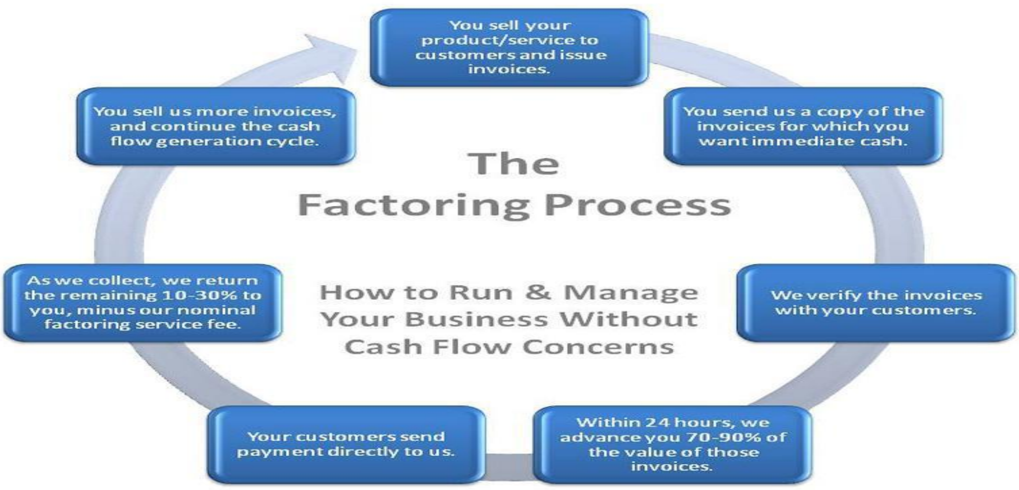
3. Banks enter into forward contract with importers and exporters for sale and purchase of foreign exchange at fixed rate.

4. Issue of solvency certificates.

5. Banks get trade information and disseminate it to the importers and exporters.

Leasing Finance: It is a method of financing machinery and equipment where the person or a company acquires the use of an asset by paying pre-determined amount called rental for a period of time.

Factoring: is a continuing arrangement between the financial institutions (factor) and business concern (client) which sells goods and services to trade customers whereby, the factor purchases the clients accounts receivables either with or without recourse to the client and in relation there to controls the credit extended to customers and administer sales ledger. Some of the basic services provided are: Administration of sales ledger, Collection of debit purchased, advisory services relating to expenses and credit and financial dealings. Covering the credit risk involved.



GIFT Cheques: Certain amount of money from the account is given to the payee listed on the cheques.GIFT CHEQUES intended to be given as gift on occasions such as wedding, birthdays, etc., are issued in fixed denominations.

Underwriting of securities: Commercial banks underwrite portion of public issue of shares, bonds and debentures of joint stock companies. Such underwriting provides an indirect form of insurance to companies on the event of public subscriptions falling short of expectations.

Tax consultancy: This service is intended to help tax payers who may not be able to afford a consultant of their own.

House Financing: Banks provide housing finance for long term at a very competitive rate of interest.

Credit cards: Unable customers to purchase goods or services from certain limit without making immediate payment. The establishment gets payed By bank operating the plan. The bank assumes risk is responsibility of collecting due from customers.

Consultancy function: SBI and Indian bank has setup consultancy cell to provide services to small scale industries.

Teller system: Under this system the teller is authorized to receive cash and make payment up to a limited amount without referring to ledger balance and spaceman signature.

Investment Policy of Commercial Banks:

The basic aim of commercial banks like any other business is to make profit. Capacity of the bank is to make profit depends on its investments.

Port folio management refers to the management of assets and liabilities of bank in order to seek optimum combination of profit, liquidity and safety. The investment policy mainly depends on these factors:

1. Liquidity:

it is the capacity of the bank to produce cash when demanded. Liquid assets are those which can be converted into cash without loan and within a short period.e.g treasury bills or exchange etc…

2. Safety:

Banks must excurses the greatest care and vigilance in the matter of investing its funds received from public in the form of deposits. a bank must estimate the amount of risk attached to various types of available assets, compare estimated risk, consider both long-run and short- run consequences and strike a balance.

3. Profitability: The main objective of a bank is to earn income to meet all its expenses and pay a fair return to its stake holders.

PRINCIPLES TO SECURE BALANCE BETWEEN LIQUIDITY, PROFITABILITY AND SAFETY ARE:

a) Diversity
b) Stability
c) Liquidity
d) Safety
e) Profitability

Indicators of Liquidity: a) CRR (CASH RESERVE RATIO): It is the ratio of cash with itself and with RBI to total deposits. Higher the CRR better is the liquidity position.

b) Liquidity ratio: also called cash plus liquid assets to deposit ratio. It refers to the investments in liquid assets.

c) Loan to deposit ratio: It is the ratio of total loans to total deposits of a bank. It is also called as credit deposit ratio. Higher this ratio lower is the liquidity.

FACTORS INFLUENCING LIQUIDITY BANK:

a) CRR
b) Banking system
c) Use of cheques
d) Nature of business conditions
e) Nature of money market
f) Nature of depositors
g) Seasonal conditions

h) Policy of fellow bankers
i) Clearing house facility

Need For Reforms

The need for financial sector reforms in the banking sector had arisen due to the following factors

- The growing sickness among financial institutions either due to state induced rigidities or directed credit allocations.
- Deterioration in the quality of loan portfolio.
- Declining productivity, efficiency and profitability of bank.
- Inadequacy of capital accompanied by inadequacy of loan loss provisions.
- Poor accounting and disclosure practices.
- Outdated work technology and poor customer services. Lack of delegation of authority and inadequate internal controls. To increase the allocations efficiency of credit

Objectives of Reforms

- To improve the efficiency and effectiveness of the banking system with special reference to economy of operations accountability and profitability
- To infuse greater competitive vitality into banking system so as to make the banks respond more effectively in the emerging needs of the economy.
- To ensure rationalization in the interest rate structure by replacing the administered system of interest rates.
- To build financial infrastructure relating to supervision, audit, technology and legal matter.
- To develop competitive, diversified, autonomous and transparent banking system.
- To initiate financial sector reforms, the government constituted a high powered committee under the chairmanship of M.NARASIMHAN, former governor of the RBI in august 1991. The committee submitted its recommendations on 16 November,1991The priority sector should be redefined to include only weaker sections of the rural society
- An asset Reconstruction Fund is set- up to takeover a portion of bad and doubtful debts of nationalized banks at a discount.
- No income should be recognized in respect of non-performing assets.
- The assets are to the classified properly and adequate provision should be created for sub-standing, doubtful and loss assets.
- An asset Reconstruction Fund is set- up to takeover a portion of bad and doubtful debts of nationalized banks at a discount.
- No income should be recognized in respect of non-performing assets.
- The assets are to the classified properly and adequate provision should be created for sub-s

Narasimhan Committee 1998

Once again in 1998, a committee was appointed under the chairmanship of Shri.M.NARASIMHAM to recommend reforms in the Indian banking sector. The main recommendations of this committee are:

- To wind up unhealthy banks and merge strong ones with weak ones.
- To have three-tier big banking structure as follows:
- Two or three big banks with international character.
- Eight to ten banks with national character.
- Local banks with local character confining to limited area, Banks with high non-performing assets should follow “Narrow Banking” by taking up only riskless business standing, doubtful and loss assets
- Private Banks should be permitted to enter into the banking sector.
- The capital adequacy ratio shall be further enhanced to improve their financial strength.
- An asset reconstruction fund shall be set-up to take over the bad debts of banks at a discount.
- A board financial regulation and supervision shall be constituted to supervise banks effectively.
- The powers of the Debt Recovery tribunals may be increased to recover debts.
- Banks are advised to introduced effective risk management systems to cover various risks such has credit risks, market risks, and operational risks on a priority basis. To achieve this, banks have been asked to set-up asset liability management practices
- Banks are directed to bring down their NPAs to 3 per cent by 2002.
- Banks should ensure a sound loan reviews mechanism for larger advances soon after its sanction and continuously monitor and identify weakness, if any, in the advances so as to take appropriate timely action.
- The RBI Act, The Banking Regulation Act, The SBI Act, etc., should be updated so as to bring them in line with the current needs of the banking industry.
- Non-banking financial companies lending activities should be integrated with financial system.
- The public sector banks should speed up computerization and their focus should be on relationship banking…

Important Questions

Section A

1. What are commercial banks?
2. What is statutory definition of Bank?
3. What is bank rate?
4. State any four public utility functions of a bank.
5. What is Bank OD?
6. What is CRR?
7. What is cash credit?
8. What is Letter of credit?
9. What is liquidity?
10. What is Factoring?
11. What are financial assets?
12. Expand AMC and CRR.

Section B

1. What are the forms of advances given by commercial bank?
2. What are factors determining liquidity of banks
3. What are the factors considered by a banker while sanctioning loan?

Section C

1. What are the primary and secondary functions of commercial banks?
2. Explain the investment policy of commercial bank.

Unit 4 – Regulatory Institutions

Introduction: Imperial Bank of India was initially performing the functions of a central bank especially as a banker to the government. There came a need for a reserve bank free from political influences, RBI started functioning from April 1935. RBI: RBI as a central bank of India occupies a very significant role in Indian banking and financial system. Being the Apex bank, it acts as a guide, regulator, controller, promoter of financial system. It was established in the year 1935, under the RBI act 1934 with the objective of securing monetary stability in India and generally to operate currency and credit system in India.

RBI Constitution: RBI was originally a share holders bank with a capital of 5 crores divided into 5 lakh fully paid up shares of 100 each., after Independance RBI was Nationalised and was acquired by Central government on 1949 1st January.

Management: It consists of 20 members consisting of the following members:

1. One governor and four deputy Governors appointed by Central government
2. Four Directors nominated by Central Government one from each of Local Board
3. Ten Directors nominated by Central Government
4. One government official nominated by the Central Government.

Functions of the RBI:

1. Monopoly of Note Issue: RBI has the sole right to issue dates, it has 2 departments issue department and banking department
   i) Issue department: issue of currency for circulation
   ii) Banking department: withdrawal from circulation
2. Banker to the government: RBI acts transacts banking business of Central and State Government, it undertakes to accept money, makes payment and also carries exchange remittance and other banking business for the Government.
3. Adviser to the Government: RBI advises Government on various economic issues and also in framing monetary policies, five year Plans and budget.
4. Controller of credit: It has the monetary authority of the country. Formulation and administering monetary policies in terms where money supply is to be expanded sufficiently to match the growth of real National income.
5. Custodian of Foreign Exchange Reserve: it is RBI responsibility to maintain the external value of the rupee, RBI holds most of Nations foreign exchange reserve.
6. Bankers Bank: RBI has the extensive power of supervising and controlling of commercial and co operative banks, its function involves establishment of banks, branch expansion, maintaining and managing liquidity of Assets, Amalgamation, reconstruction and liquidation.

7. Lender of last resort: In the event of emergency banks approach the RBI for financial accommodation. The scheduled banks can borrow from RBI on the basis of eligible securities or by rediscounting their bill of exchange.RBI is ready to help banks in distress and hence it is referred as lender of last resort.
8. Bank of settlement and clearance: it enables the member banks to adjust their claims against each other in the books of RBI without paying or receiving cash.
9. Information and research: RBI undertakes collection and dissemination of information and conducts research in this field, it issues several periodicals, publications also attempts the significance of economic and fiscal developments in the country.

Instruments of credit control

1. Quantitative/General credit control
2. Qualitative/Selective credit control

Quantitative methods are:

1. Bank rate: it is the standard rate at which the bank is prepared to buy or discount bills of exchange or other commercial papers eligible for purchases under this act.
2. Variable Reserve Ratio: scheduled banks are required to maintain with RBI a minimum cash balance as reserve, by varying this reserve, RBI could undertake could take quantitative control.
3. Statutory liquidity Requirement: Banks are required to maintain liquid assets in cash, gold and securities not less than 20 % of total demand and liabilities.
4. Differential rate system: under this system, banks were given a basic quota to a specific percentage of statutory requirements; if borrowings exceed this limit then RBI charges higher interest rates.
5. Net liquidity Ratio: it is a new system of sliding scale of interest based on net liquidity ratio of the borrowing.
6. Open market operations: it refers to the purchase and sale by central bank a variety of assets such as Gold, government securities, foreign exchange and company shares.
   Selective or qualitative credit control methods:
   1. Rationing of credit: it is the control exercised by RBI for which credit is g ranted among the various applicants
   2. Margin requirement: it refers to the proportion of prices of securities which banks and other security dealers are not permitted to lend, the objective is to restrict speculative dealings in stock market.
   3. Consumer credit regulation: RBI restricts consumer expenses on non essential items by directing the commercial banks by fixing minimum percentage of down payment.
   4. Publicity: by educating public about monetary situation through journals and publications
   5. Moral Suasion: RBI also exercises control over credit by issuing letters to banks by urging them to exercise control over credit in general or advances against specified commodities or unsecured advances in particular.

6. Direct action: it refers to all forms of restriction imposed upon commercial banks.
   Securities Exchange Board of India
   SEBI was set as a non statutory body on 12th April, 1988. It got its statutory power in the year 1992.

   Objectives of SEBI
   1. To protect the interest of investors to ensure steady flow of savings into capital market
   2. To regulate securities market and ensure fair practices by issuers of securities
   3. To promote efficient services by brokers, merchant bankers and intermediaries to become competitive and professional.

Functions of SEBI:

1. Regulatory functions:

a) Regulation of stock exchange and self regulatory organisation.

b) Registration and regulation of stock brokers, sub brokers, merchant bankers, underwriters, port folio managers etc

c) Prohibition of insider trading in securities

d) Regulating substantial acquisition of shares and takeover of companies.

e) Prohibition of fraudulent and unfair trade practices relating to securities market.

2. Development functions
   a) Promote investors education
   b) Training of intermediaries
   c) Conducting research and published information useful to all market participants
   d) Promotion of fair practices. code of conduct for self regulatory organisations
   e) Promoting self regulatory organisations

f) Information and Research functions: collects and disseminates information and conducts research in this field.

g) Supervision of Banks: It has the extensive power of supervision and control over commercial and cooperative banks. It has power to call for information and give directions to them.

h) Monetary data and publications: it is the main source of information about Monetary data and Banking system .

I) Promotional functions: It has been performing a variety of promotional functions towards building and strengthening of financial infrastructure by promoting commercial, co operative, industrial and agriculture banks and also promotion of finance of exports.

Powers of SEBI

1. Power to call for periodical returns from recognised stock exchange
2. Power to call for any information or explanation from recognised stock exchanges
3. Power to direct enquiries to be made in relation to affairs of stock exchanges or their members
4. Power to grant approval to bye laws of recognised stock exchange
5. Power to make or amend bye laws of recognised stock exchange
6. Power to compel listing of securities by public companies
7. Power to control and regulate stock exchanges
8. Power to grant registration to market intermediaries
9. Power to levy fees.

Organisation of SEBI

It consists of six members. The chairman and 2 members are to be appointed by central government and one member by RBI and 2 members having experience in stock market to be appointed by central government. Apart from Central Board of Directors, four Local Boards are constituted representing each area at Mumbai, Kolkata, Chennai and New Delhi consisting of different departments such as:

1) Issue Department which issues currencies

2) Banking Development helps to develop banking in all areas

3)Banking operation helps in controlling, supervising and regulating working of banking functions and also helps in granting licences to open new branches

4) Non Banking Companies: Supervises the functioning of NBFCs

SEBI is divided into 4 operational departments:

1. Primary market department : deal with policies and regulatory issues relating to primary market
2. Issue management and intermediaries department: regulation and monitoring of issues relating to intermediaries and registrations
3. Secondary market department: it looks after all policies and regulatory issues for secondary market.
4. Institutional investment department: is concerned with framing policies for FII, MFs and takes care of publications and membership in international organisations.

5) Legal Affairs: provides legal advice on legal issues.

6) Exchange Control: deals with sale & purchase of Forex

7) Agriculture credit

8) Industrial Finance

9) Economics Department to frame banking policies

10) Research Statistics: Collection of details relating to money, credit, production etc.

11) Banking department keeps the RF of Commercial banks and assistance to FIs

12) Inspection department: inspects local offices of commercial banks

1 3) Planning and reorganisation: formulates new policies and plans

14) RBI services board deals in recruitment, selection

15) Accounts and Expenditure maintains the receipts and expenses.

16) Supervision: supervising commercial banks

17) Control department: controls the affairs

18) External investments and operations

19) Press relations

20) Industrial Export credit.

Important Questions

Section A

1. What is RBI?
2. State any four functions of RBI.
3. What is bank rate?
4. Give meaning of open market operation
5. State the two credit control instruments used by RBI.
6. Expand SEBI and RBI.
7. What are objectives of SEBI?

Section B

1. Discuss briefly organisation of RBI.
2. What is monetary policy? Explain its objectives.
3. What is credit control? Explain quantitative credit control techniques.
4. Discuss organisation structure of SEBI.
5. State objectives of SEBI.
6. What are powers and functions of SEBI?

Section C

1. Explain the functions of RBI.
2. Explain organisation and management of SEBI
3. What is qualitative credit control? Discuss various methods.

CHAPTER 5 -FINANCIAL SERVICES

Financial services in broader sense means mobilising and allocating savings, it includes all activities involved in transformation of savings into investment. It is also called as financial intermediation, it is a process by which funds are mobilised from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers. Financial services are classified into the following categories:

<u>Financial Services</u>

Traditional Activities **Modern**
Activities

Fund Based **Non Fund Based**

Fund based activities:

1. Underwriting or investment of shares

2. Dealing in secondary market Activities

3. Participating in money market

4. Equipment Leasing, hire purchase etc

5. Dealing in foreign exchange market.

Non Fund Based/ Fee based Activities: these activities mainly involve the following:

1. Managing capital issues

2. Placement of capital and debt instruments

3. Arrangement of funds

1. Capital Restructuring

2. Mergers and acquisitions

3. Rehabilitation of sick units

4. Credit rating

5. Credit cards

6. Risk management services

7. Merchant banking

8. Loan syndication

9. Mutual funds

10. Factoring and forfeiting

11. Venture capital financing

12. Custodial services

13. Depository services

14. Secretion of debts

15. FOREX services

Types of Financial Services

1. Merchant banking service: It is an institution which covers a wide range of activities such as management of customer services, portfolio management, credit syndication, acceptance credit, counselling, insurance etc.

2. Mutual Fund service: it is a fund established in the form of a Trust by a sponsor, to raise money by the trustees, through the sale of units to the public, under one or more schemes for investing in securities in accordance with these regulations.

3. Leasing Finance service: it is an arrangement between 2 parties, the leasing company or lessor and the user or lessee, where by the former arranges to buy capital equipment for the use of the latter for an agreed period of time in return for the payment of rent.

4. Venture capital financing services: it refers to investment in new and tried enterprises that are lacking a stable record of growth. it is a long term risk capital to finance high technology projects which involve risk but at the same time has strong potential form of growth.

5. Factoring and forfeiting: Factoring is a method of financing whereby company sells its trade debts at a discount to a financial institution and forfeiting is defined as the non resource purchase by a bank or any other financial institution, of receivables arising from an export of goods and services.

6. Custodial services: a custodian is one who keeps the safe custody of the valuables of his customer client or investor.

7. Advisory services: Advising the clients on selecting the best source of funds, their codst, lending period.

8. Depository services: it is a central location for keeping securities on deposit, it is a facility for holding securities, either in certificated or uncertified form to enable book entry transfer of securities.

9. Housing finance services: investment in housing is considered as a hedge against inflation, since in most cases the rise in land values is more than the rise in inflation rates.

10. Vehicle loans services: Vehicle loans are given to purchase a new or used vehicle of any make to individuals, professionals and business people.

11. Consumer finance services: this is given for those wishing to purchase consumer durables including furnitures, computers and other household articles

DEFINITON:

Factoring is a continuing arrangement between the financial institutions (factor) and business concern (client) which sells goods and services to trade customers whereby, the factor purchases the clients accounts receivables either with or without recourse to the client and in relation there to controls the credit extended to customers and administers sales ledger. Some of the basic services provided are:

Administration of sales ledger

Collection of debit purchased,

Advisory services relating to expenses and credit and financial dealings,

Covering the credit risk involved.

Factoring is the Sale of Book Debts by a firm (Client) to a financial institution (Factor) on the understanding that the Factor will pay for the Book Debts as and when they are collected or on a guaranteed payment date. Normally, the Factor makes a part payment (usually up to 80%) immediately after the debts are purchased thereby providing immediate liquidity to the Client.

So, a Factor is,

a) A Financial Intermediary

b) That buys invoices of a manufacturer or a trader, at a discount, and

c) Takes responsibility for collection of payments.

The parties involved in the factoring transaction are:-

a) Supplier or Seller (Client)

b) Buyer or Debtor (Customer)

c) Financial Intermediary (Factor)

Services offered by Factor:

1. Follow-up and collection of Receivables from Clients.
2. Purchase of Receivables with or without recourse.
3. Help in getting information and credit line on customers (credit protection)
4. Sorting out disputes, if any, due to his relationship with Buyer & Seller.

Mechanics of Factoring

- The Client (Seller) sells goods to the buyer and prepares invoice with a notation that debt due on account of this invoice is assigned to and must be paid to the Factor (Financial Intermediary).
- The Client (Seller) submits **invoice copy only** with Delivery Challan showing receipt of goods by buyer, to the Factor.
- The Factor, after scrutiny of these papers, allows payment (, usually up to 80% of invoice value). The balance is retained as Retention Money (Margin Money). This is also called Factor Reserve.
- The drawing limit is adjusted on a continuous basis after taking into account the collection of Factored Debts.
- Once the invoice is honored by the buyer on due date, the Retention Money credited to the Client‟s Account.
- Till the payment of bills, the Factor follows up the payment and sends regular statements to the Client.

Forfaiting: Forfait" is derived from French word „A Forfait‟ which means surrender of fights.

Forefaiting is a mechanism by which the right for export receivables of an exporter (Client) is purchased by a Financial Intermediary (Forfaiter) without recourse to him.

It is different from International Factoring in as much as it deals with receivables relating to deferred payment exports, while Factoring deals with short term receivables.

- Exporter under Forfaiting surrenders his right for claiming payment for services rendered or goods supplied to Importer in favor of Forefaiter.
- Bank (Forefaiter) assumes default risk possessed by the Importer.
- Credit Sale gets converted as Cash Sale.
- Forfaiting is arrangement without recourse to the Exporter (seller)
- Operated on fixed rate basis (discount)
- Finance available up to 100% of value (unlike in Factoring)

Leasing: A lease is a contractual agreement between the lessor (owner) and the lessee (second party) for a specified asset, which can be property, a house or apartment, business or office equipment, an automobile or even a horse. The lessee receives the right to total ownership for a spelled out period of time and conditions in return for payments. Do not confuse a lease with a rental, although these words are often interchanged. A rental is for a short period of time, such as a month, where, in this case, the agreement is renewed or the terms are changed monthly.

Benefits of leasing:

1. Permits alternative use of funds: enables use of asset without the huge capital expenditure.

2. Faster and cheaper credit: Acquisition of assets is cheaper and faster than any other source of funds

3. Flexibility: leasing arrangements may be tailored as per lessees needs.

4. Facilitates additional borrowing

5. Protection against obsolescence: it is highly useful in those assets which become obsolete or outdated at a faster rate.

6. No restrictive covenants: declaration of dividends,debt equity ratio are absolutely absent in lease agreement

7. 100 % financing: enables to acquire use of asset without any such down payment.

8. Boon to small firms: as acquiring asset with no down payment and utilising the same fund for other avenues.

Disadvantages of Leasing:

1. Lease in not suitable mode of project finance.

2. Tax benefits cannot be availed

3. Value of capital assets may increase during the lease period.

4. Cost of financing could be higher.

Termination of contract in the middle of the agreement period becomes difficult

5. Lessor would suffer loss if rentals are not paid regularly.

6. Lessee is not entitled for any protection if there is a breach of warranties.

Venture Capital Financing Services

Venture capital is a form of equity financing designed especially for funding high risk, technology and high reward projects. It is a capital provided by the firm of professionals who invest alongside management in young, rapidly growing or changing companies that have potential for high growth.

Definition: it is a financing institution which joins an entrepreneur as a co promoter in a project and shares the risk and rewards of the enterprise.

Features:

1. it is in the form of an equity formation
2. Investment is made only on high risk but high growth potential projects.
3. It involves commercialisation of new ideas or new technology.
4. It joins the entrepreneurs as co promoter in projects.
5. Investment is usually made in small or medium scale enterprise.
6. There is continuous involvement in business even after making an investment by the investors.

Importance of Venture Capital.

1. Advantages to investing public: public is safe as there is a detailed scrutiny of the company by the venture capital officials so that the credentials are justified.
2. Advantages to promoters: It is easy for the entrepreneurs to get funds from Venture fund by just convincing the officials than convincing tons of underwriters, investors etc
3. It reduces the time gap between technological innovations and its commercial exploitation.
4. It helps in developing new process and projects.
5. It induces the entry of large no of technocrats in industry.
6. It acts as an intermediary between the investors and entrepreneurs in search of needed capital.

Housing Finance Service: It refers to providing finance to the individual or group of individuals for the purchase, construction or related activities of house or flat. It is a type of instalment credit which forms the largest single source of housing finance.It is availed for construction, extension, purchase, combined for purchase and construction.

Reasons for increasing popularity of Housing loans:

1. Safety Advances: since it is backed by mortgage of house
2. Refinance facility: as there will not be financial crunch for bankers as they can avail from NHB
3. Asset liability management: it becomes an easy task
4. Priority sector Advance
5. Low default
6. Reduction in risk weight age
7. Asset Reconstruction company: it enables securitisation of mortgaged housing loans

Vehicle Loans Service: it is given to purchase a new or used vehicle of any made to individuals, professionals and business people.It is extended for a period from 1 to 5 years and rate of interest varies from bank to bank.

Consumer Finance: it refers to the raising of finance by individuals for meeting their personal expenditure or for acquisition of durable consumer goods and for purchase / creation of an asset. It is an important asset based financial service in India with an objective of providing finance on easy terms and at door steps of consumer. It is generally extended for a period from 1 to 5 years. Various important aspects include:

1. Parties to the transaction: whether it is bipartite or a tripartite arrangement.
2. Mode of consumer finance: whether it is Hire purchase, instalment system, overdraft or credit card.
3. Procedure for granting loan: it involves pre sanction stage and post sanction stage.
4. Terms of financing: it involves stipulations regarding amount of credit, period of credit, margins, security requirements, rate of interest and documentation.
5. Purpose of raising finance: whether loan is availed for housing,educational purpose, personal reasons, festival expenses etc.

Important Questions

Section A

1. What are financial services?
2. What is factoring?
3. What is venture capital?
4. Define leasing.
5. What is forfeiting?
6. What is bill discounting?
7. What is consumer finance?
8. What is credit rating?
9. Name any two credit rating agencies in Indian.

Section B

1. Write functions of financial services.
2. What are features of factoring?
3. What is leasing? What are its types?
4. What is the process of venture capital investment?
5. What is housing finance? What is the procedure to avail housing loan?

Section C

1. Explain different types of financial services.
2. Define venture capital what are its features and processes?
3. What is leasing? Explain the different types of leasing.

III Semester B.Com. Examination, Nov./Dec. 2007
(Semester Scheme)
INDIAN FINANCIAL SYSTEMS
(Paper - 3.6)

Time : 3 Hours Max. Marks : 90

Instruction : Write completely in English or in Kannada.

SECTION - A

Answer any ten questions. Each question carries 2 marks. (10x2=20)

1. a) What is secondary market ?
b) Write two differences between money market and capital market.
c) What is overdraft ?
d) Expand SHCIL.
e) State any four public utility functions of Banks.
f) Give the meaning of Scheduled Bank.
g) State any four functions of RBI.
h) Give the meaning of Credit Card.
i) Give the meaning of Debentures.
j) What are financial assets ?
k) State two objectives of ICICI.
l) State any four types of Mutual Funds.

SECTION - B

Answer any five questions. Each question carries five marks. (5x5=25)

2. Write a note on industrial security market.
3. State the Merchant Banking functions.
4. State the advantages of credit cards.
5. State the features of a developed money market.
6. Discuss the primary market for industrial securities.
7. State the regulatory functions of SEBI.
8. Briefly explain the structure of Indian financial system.
9. Write the indicators of liquidity of a bank.

SECTION - C

Answer ant three questions. Each question carries fifteen marks. (3x15=45)

10. Briefly explain the components of money market.
11. Explain the important financial services.
12. What is credit control ? Explain the quantitative credit control techniques of RBI.
13. Explain the functions of a Commercial Bank.
14. Briefly explain the banking innovations.

III Semester B.Com. Examination, May2008

INDIAN FINANCIAL SYSTEMS

Time : 3 Hours Max. Marks : 90

SECTION - A

Answer any ten questions. Each question carries 2 marks. (10x2=20)

1. a) What is secondary market ?
b) Write two differences between money market and capital market.
c) What is overdraft ?
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e) State any four public utility functions of Banks.
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3. State the Merchant Banking functions.
4. State the advantages of credit cards.
5. State the features of a developed money market.
6. Discuss the primary market for industrial securities.
7. State the regulatory functions of SEBI.
8. Briefly explain the structure of Indian financial system.
9. Write the indicators of liquidity of a bank.

SECTION - C

Answer ant three questions. Each question carries fifteen marks. (3x15=45)

10. Briefly explain the components of money market.
11. Explain the important financial services.
12. What is credit control ? Explain the quantitative credit control techniques of RBI.
13. Explain the functions of a Commercial Bank.
14. Briefly explain the banking innovations.

III Semester B.Com. Examination, Nov./Dec. 2007
(Semester Scheme)
INDIAN FINANCIAL SYSTEMS
(Paper - 3.6)

Time : 3 Hours Max. Marks : 90

Instruction : Write completely in English or in Kannada.

SECTION - A

Answer any ten questions. Each question carries 2 marks. (10x2=20)

1. a) What is secondary market ?
b) Write two differences between money market and capital market.
c) What is overdraft ?
d) Expand SHCIL.
e) State any four public utility functions of Banks.
f) Give the meaning of Scheduled Bank.
g) State any four functions of RBI.
h) Give the meaning of Credit Card.
i) Give the meaning of Debentures.
j) What are financial assets ?
k) State two objectives of ICICI.
l) State any four types of Mutual Funds.

SECTION - B

Answer any five questions. Each question carries five marks. (5x5=25)

2. Write a note on industrial security market.
3. State the Merchant Banking functions.
4. State the advantages of credit cards.
5. State the features of a developed money market.
6. Discuss the primary market for industrial securities.
7. State the regulatory functions of SEBI.
8. Briefly explain the structure of Indian financial system.
9. Write the indicators of liquidity of a bank.

SECTION - C

Answer ant three questions. Each question carries fifteen marks. (3x15=45)

10. Briefly explain the components of money market.
11. Explain the important financial services.
12. What is credit control? Explain the quantitative credit control techniques of RBI.
13. Explain the functions of a Commercial Bank.
14. Briefly explain the banking innovations.

Reference

1. INDIAN FINANCIAL SYSTEM by E. Gordon and K.Natarajan

2. INDIAN FINANCIAL SYSTEM by Shashi K Gupta, Nisha K Aggarwal and Neeti Gupta

3. INDIAN FINANCIAL SYSTEM by Swamynathan C, Abhirami D and Shivashankari V.R