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Skill Enhancement Course (SEC) - Commerce

FINANCE FOR EVERYONE

Department of Commerce

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CONTENTS

Unit-I

LESSON-1

INTRODUCTION TO FINANCIAL LITERACY

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STRUCTURE

1.1 LEARNING OUTCOMES

By the end of this chapter learners will be able to:

- Describe the concept of finance and financial literacy
- Explain the importance of studying finance
- Understand the various qualifications required for financial literacy
- Know the concept of financial institutions (FIs) and the services they provide

1.2 INTRODUCTION

Financial goods and services have expanded across society more and more in recent decades. While past Indian generations would have mostly paid with cash for their purchases, several credit instruments, like credit and debit cards and electronic transfers, are now widely used. Given the significance of finance in contemporary culture, a person's long-term financial success may suffer greatly if they are not financially literate.

Financial ignorance can result in a number of dangers, including a higher likelihood of building up unmanageable debt loads due to bad spending choices or a lack of long-term planning. This can then result in bad credit, bankruptcy, home foreclosure, and other unfavourable outcomes.

Thankfully, there are more tools than ever available for anyone who wants to learn more about the financial world, including books, the internet, social media, financial advisors, banks, government organizations, schools, and institutions, etc.

1.3 FINANCIAL LITERACY

Meaning and Definition

Do you sometimes face shortage of funds at the end of every month or are not able to buy the things you really want due to shortage of funds. Answer to these questions requires knowledge of financial activities. We should know how to balance our incomes and expenses. As people transition into adulthood, financial literacy is an essential skill to have. Financial literacy gives many people a feeling of empowerment and can enhance their quality of life. They frequently pick it up in school or from their parents and friends. But many Indians still lack access to financial literacy, particularly those from disadvantaged families who lack equal possibilities for education and learning from others. Despite being introduced over 400 years ago, the term "financial literacy" has been bandied around for years in a variety of industries without having a clear definition in academics. The working definition provided by the Organization for Economic Cooperation and Development (OECD) has gained widespread acceptance among experts. The Organization for Economic Co-operation & Development (OECD) defines Financial Literacy and Financial Education. **Financial Literacy** is defined as "a combination of financial awareness, knowledge, skills, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial well-being" (OECD, 2012) and is most frequently used interchangeably with phrases like "financial education", "financial awareness", and "financial confidence".

Financial Education, on the other hand is defined as "the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help and to take other effective actions to improve their financial well-being" (OECD, 2005).

According to the OECD, a person must have knowledge in four crucial areas before they can be considered fully financially literate: money and transactions, planning and managing finances, risk and reward, and the financial landscape (OECD, 2020, p. 43). The OECD emphasizes the significance of gaining these abilities while a person is still in high school so that the knowledge can prepare them for their adult lives. This will help an individual to be prepared in their life.

The financial literacy definition developed by the National Financial Educators Council: "Possessing the skills and knowledge on financial matters to confidently take effective action that best fulfills an individual's personal, family and global community goals".

The capacity to comprehend financial ideas and make financially responsible decisions is known as financial literacy. It includes knowing how to make money, save money, invest money, and borrow money. More specifically, it refers to the combination of abilities and information that enables a person to use all of their financial resources to make wise decisions. Different aspects of financial literacy comprise:

- Being financially literate means having the capacity to manage one's personal finances, including how to earn, spend, save, invest, and borrow money.

- Personal financial management, succession planning, choosing investments, and tax preparation are all include
- Short-term courses on investment, financial management, and budgeting can help people learn about finances.
- One can also study blogs and books, work as an intern at a financial firm, and speak with financial experts.

Financial literacy can help people become self-sufficient and attain financial stability by preventing them from making bad financial decisions. Developing financial literacy requires taking important measures like understanding how to make a budget, keep tabs on spending, pay off debt, and make retirement plans. Learning about these subjects also include understanding how money functions, establishing and accomplishing financial goals, being aware of unethical or discriminatory financial activities, and handling the difficulties that life presents.

It is clear that although the terms financial education and financial literacy are related, they are not the same. Through the process of financial education, people develop financial literacy. The development of financial literacy equips users to make wise financial decisions that lead to personal financial well-being. It is clear that although the terms financial education and financial literacy are related, they are not the same. Through the process of financial education, people develop financial literacy. The development of financial literacy equips users to make wise financial decisions that lead to personal financial well-being.

Components of Financial Literacy

Knowing how to handle money, plan for short- and long-term financial objectives, and select the right financial products are just a few examples of the information, attitude, and behavior that make up financial literacy.

(1) Understanding fundamental financial principles and being able to weigh benefits in practical financial circumstances include **financial knowledge**. A person's financial

literacy is examined using the concepts of simple interest, compound interest, time value of money, inflation, diversification, division, risk-return, and interest paid on loans.

(2) **Financial behavior** is the study of how people manage their money on a day-to-day basis, make financial plans, spend, save, and invest, rely on credit to cover expenses, and create safety nets for their future well-being.

(3) Studying people's **attitudes** toward saving, placing short-term desires over long-term stability, propensity for risk, and other factors that affect future well-being is the goal of financial attitude.

Activity-1

Mr. Rohit is earning Rs 50,000 per month as income from various sources and he spends Rs. 10,000 on rent for the house, Rs.20,000 on education fees, Rs. 10,000 for grocery items and Rs. 10,000 on luxury items such as watches, branded clothes etc. Mr. Rohit is satisfied as his expenditure is equal to his income. On the other hand, he is not able to save any money for future contingencies. What is your opinion about the financial planning and literacy of Mr. Rohit. Write your answers along with the reasons.

IN-TEXT QUESTIONS

1 Financial literacy is the ability to understand ------------.

2 Financial literacy is related to -----------------

3 For better financial decisions everyone is required to have knowledge of ------------

1.3.1 Importance of Financial Literacy

Everyone should be financially literate since it will provide the knowledge and skills to manage the money wisely. Due to modern society's daily challenges of life, such as credit cards, investments, mortgages, school loans, and health insurance, the absence of the same will result in a weak basis for actions and decisions about savings and investments. Consumers who are financially educated are better equipped to handle life's inevitable ups and downs because they know how to avoid problems before they happen and how to deal with them when they occur.

The following are some effects of financial literacy on our life:

- **Recognize your income and expenses**: Making a budget is a crucial step in developing financial literacy since it allows one to truly grasp income and expenses. Once we have established a budget, we can monitor our spending and recheck it on a regular basis. Consumers who are financially literate are more likely to save consistently for goals that are important to them, such as a vacation or their child's college education.
- **Pay off debt and stay out of debt**: When comparing loan terms, looking for the lowest interest rates can result in significant long-term savings, as can paying off full credit card balances in each month to avoid interest costs.
- **Avoid going into debt or declaring bankruptcy**: Establishing an emergency savings account is a critical step in preventing debt from accumulating. Make a plan for regular savings and day to day expenses. Reduce unnecessary expenses and put your savings into a separate account. Try to save money to buy required things. Spend on things you need, but wisely.
- **Strive for a safe retirement:** Through Financial literacy we have a better sense of how much to save, what kind of retirement we want, and how to get there
- **Learn the value of saving** and start saving as soon as we can, even if it's just a little bit. Regular savings are a cushion for emergency conditions. For regular savings we can opt compulsory saving schemes such as Recurring Deposit, Systematic Investment Plan (SIP) etc.
- Financially literate persons are less likely to fall victim to **financial fraud**

A vital life skill that can help people achieve their financial goals, maintain financial security, and experience less anxiety is financial literacy. Here are five ways that being financially savvy can be **beneficial**:

1. **Gives More Self-Assurance While Making Financial Decisions.**

   We are more prone to depend on others to make decisions for us when we are oblivious to our financial options. When picking a location for winter, spring, or summer break, that can be acceptable. But when it comes to making important financial choices in life (like selecting a mortgage lender, setting aside money for a 4 over 5, or paying off debt), being aware of all of the alternatives provides the assurance to go with what's best available.

2. **Gives the Ability to Bargain.**

   We may express our expectations more effectively if we are financially literate. Our ability to negotiate for the best alternative will significantly improve the better informed we are, whether it's negotiating down interest rates on money we borrow or bringing up the goals we have for the money we invest.

3. **Makes it Easier to Defend Yourself.**

   The more we know about identity theft and internet scams, the better equipped we'll be to guard against becoming a victim of financial fraud.

4. **Increases Our Likelihood of Reaching Our Objectives.**

   Setting financial objectives is one thing. However, when it comes to turning our financial aspirations into reality, having a greater understanding of what it takes to achieve those goals can make all the difference.

5. **Offers a Higher Standard of Living All Around.**

   Understanding our finances helps us achieve more while reducing stress. It is a fact as well as a philosophy. The most financially literate persons seem to be among the best earners. People who had financial advisors also had higher levels of financial literacy.

Rationale For financial literacy

(1) **Financial conditions are affected by daily actions**. Every day, people make choices that have an influence on their finances, their domestic and personal circumstances. Whether done knowingly or unknowingly, the deeds or omissions of individuals'

(2) **Cultural hurdles and limited English proficiency** might make it difficult to succeed financially. For people with low English proficiency, specialized financial language, jargon, and processes might provide obstacles. Lack of access to translated materials or bad translations can hinder them.

(3) **Everyone is not taught about finances**. In actuality, not all individuals are given adequate information about fundamental ideas in personal finance.

(4) **Capacity to fulfill financial obligations and realizing financial goals** can be strongly impacted by their families and themselves. We all are very well aware that finance is the backbone of all other activities of life. Better understanding and clarity of our

financial liabilities and financial goals always helped to attain better life for family and themselves.

(5) **Cultural hurdles and limited English proficiency** might make it difficult to succeed financially. For people with low English proficiency, specialized financial language, jargon, and processes might provide obstacles. Lack of access to translated materials or bad translations can hinder them.

(6) **Everyone is not taught about finances**. In actuality, not all individuals are given adequate information about fundamental ideas in personal finance.

(7) **Consumers must make difficult financial choices** such as Completing legal paperwork, navigating financial services and systems, getting insurance, making retirement plans, buying a home, managing debt, weighing employment offers, or dealing with divorce or death of a family member are some of these chores and decisions.

(8) **Work performance and health** are both impacted by financial stress. Financial anxiety may have negative effects on one's health or ability to function at work. In terms of financial management, a significant portion of women are behind men. People who are financially savvy are less prone to be insecure.

(9) **1.3.2 Scope of Financial Literacy** Understanding fundamental financial concepts and having the knowledge and skills necessary to make wise financial planning decisions based on the resources at hand are two aspects of financial literacy. It involves understanding how to make, use, invest, and save money. It is the capacity to effectively manage your money by utilizing the financial tools and resources at your disposal to your greatest advantage.

Financial literacy can refer to a variety of abilities, but some common examples include creating a household budget, understanding how to manage and pay off debts, and weighing the pros and cons of various credit and investment options. These abilities frequently call for at least a basic understanding of important financial ideas like compound interest and the time worth of money. The significance of other goods has also increased, including mortgages, student loans, health insurance, and self-directed investment accounts. People now need to be aware of how to utilize them more responsibly much more than before.

Knowledge of Financial Literacy

Understanding financial ideas and principles including financial planning, compound interest, debt management, effective investment strategies, and money-time value is also necessary for financial literacy. Poor financial decisions brought on by financial illiteracy may harm a person's ability to manage their finances.

Learning how to construct a budget, keep track of costs, learn debt-reduction tactics, and properly plan for retirement are some of the main steps to enhancing financial literacy.

Financial advisor counselling is another example of such approaches. Understanding how money functions, setting and accomplishing financial objectives, and dealing with both internal and external financial obstacles are all part of financial education.

Financial literacy is the ability to manage money and debt effectively. It is made up of a number of financial skills and components-

(1) Budgeting

It is the most crucial ability for someone to possess because it aids in financial planning and management. It assists you in keeping tabs on your spending patterns, maximizing the use of your funds, and developing a workable financial plan that will assist you in keeping track of your expenses, separating out unnecessary spending, and making good financial decisions. This is how to increase your savings. By finding the right balance between the fundamental uses of money, people can make better use of their income and attain financial stability and prosperity. In general, a budget should be made in a way that eliminates all existing debt while allocating funds for savings and prudent investments. An example of a budget for a salaried employee earning a salary of Rs. 1,00,000 per month can be drawn as follows-

Expense	Monthly Expense
Rent	Rs. 30,000
Loan Repayment for car loan	Rs. 10,000
Education for Children	Rs. 15,000
Grocery Bill	Rs. 15,000
Miscellaneous Expenses	Rs. 10,000
Savings for Future	Rs. 20,000

(2) Debt

It just amounts to borrowing and spending someone else's money. Debt comprises numerous borrowing practices, including bank loans and credit card use among a few others However, not every debt is a bad debt, thus for this reason, one must be aware of the distinction between bad and good debt. This differentiation is necessary since not everyone is wealthy enough to afford everything required in life. The sole option is to take out a loan or borrow money in order to finance an education, a home, or an automobile. Borrowing money for necessities of daily living is considered good debt and can cover things like funding one's education, getting a house, or an automobile. However, obtaining credit to cover unnecessary costs, such as the purchase of luxury items by using credit cards is termed as poor credit. As a result, one should always make an effort to avoid collecting bad debts. The basics of debt management is to have the capacity to distinguish between required good debt and unnecessary bad debt is important. Avoiding excessive spending will prevent you from falling into a financial trap.

(3) Saving

Financial well-being and future security are all a result of saving. Planning of finances wisely will enable us to accumulate wealth over time. Keeping track of one's expenditures will enable one to save money, and healthy/strong saving habits can help one to accomplish a number of tasks, such as reaching financial objectives, developing financial discipline, and setting up an emergency fund, among other things.

Why Save?
Saving is very important. It will help you to meet your goals and provide for your own future.

(4) Investing

With investing we can direct our funds toward certain financial instruments rather than leaving money idle in the bank account. Investing can assist in creating and increasing wealth for future security and happiness. By investing, we can allocate certain funds and also achieve our financial objectives of post retirement life. Some of the popular investment instruments are debts, stocks, homes, mutual funds, equity linked saving schemes and gold.

As one has a good understanding of the financial concepts discussed above, their degree of financial literacy will increase.

Table 1. Sources of Guidance on Types of Financial Literacy Knowledge and Skills

National Standards for Adult Financial Education	My Money Five Principles for All Americans	National Standards in K–12 Personal Finance Education
Money Management	Earn	Spending and Saving
Credit	Save and Invest	Credit and Debt
Debt Management	Protect	Employment and Income
Risk Management	Spend	Investing
Investing and Retirement Planning	Borrow	Risk Management and Insurance
		Financial Decision Making

Activity-2

Priya is a college student and belongs to a middle-class family. She is earning some money by taking tuition classes. She wants to save this money for her higher education. For savings she has multiple options in the bank. She can open a Saving account or a Recurring Deposit account or a Fixed Deposit.

If you are Priya what will be your decision and why?

1.4 Prerequisites of Financial Literacy: Level of education and Numerical and Communication Ability

1.4.1 Level of Education

Money management is a personal talent that one develops over the course of your life and is not something that everyone learns. With money coming in and leaving out, due dates, finance charges and other expenses associated with invoices and bills, as well as the general obligation of continually making the proper decisions for significant purchases and investments.

Deposited funds

Opening a bank account is the first step in gaining financial knowledge. Set up a direct deposit as soon as one receives a paycheck. This keeps the money safe and helps us from having to pay interest to cash advance businesses that take a cut of your check as payment.

Budgeting

The knowledge of budget is one of the initial components of a good personal finance strategy. Even if it's simple to grasp, doing it demands a serious glance in the mirror and the willingness to have an idea of expected incomes and expenses.

We must examine our spending patterns and make changes as per budgeting if required. We control our money rather than money controls us. Start saving habits to keep finances stable and your mind at ease.

Investing

People who want to learn about finances should educate themselves on key elements of investing. Investors should educate themselves on a variety of topics to ensure lucrative investments, including interest rates, price ranges, diversification, risk-reduction strategies, and indices.

Borrowing

Most people will at some point in their lives need to borrow money. To ensure that borrowing is done effectively, it is crucial to comprehend interest rates, compound interest, the time value of money, payment terms, and loan arrangements.

Without savings, when you want to purchase something, you have to borrow money. Borrowing is expensive, because not only do you have to pay it back, but you also pay interest, often at a high monthly rate. Saving lets you avoid the interest you have to pay to borrow money. Most people know the reasons to save, – but many don't do it consistently. Save now.

Taxation

Understanding the various tax systems and how they affect a person's net income is a requirement for financial literacy. Whether it comes from work, investments, rental income, an inheritance, or an unanticipated windfall, every source of income is taxed differently. By effectively managing income, it is possible to improve financial performance and economic stability.

Financial Management for Individuals

The majority of the aforementioned components are combined in personal financial management, which is the most important component. In order to enhance and increase investments and savings while decreasing borrowings and debt, the aforementioned financial mix must be adjusted.

Clearly stated in a successful budget strategy are:

- How to stick to a monthly budget.
- How to cut your monthly expenditures.
- How to deal with accumulated debt

- Ways for paying off debt, such as the snowball and avalanche approaches.
- How to tell the difference between short-, medium-, and long-term objectives.
- A breakdown of household requirements

1.4.2 Communication and Numerical Skills

Learn about financial issues

Reading about investing, money management, and finances is a good place to start if one wants to start increasing financial literacy. Start by reading periodicals and newspapers or look for books that include financial literacy. We might also wish to explore financial literacy tools online, including webinars and podcasts.

Employ tools for financial management

Using a financial management tool is a crucial next step in developing financial literacy. To keep track of expenditures, there are numerous services available online that one can quickly link to checking and savings accounts, credit cards, and mortgages. We can prepare a budget using these tools, then track our financial progress to ensure that it remains within the budget limits.

Ask for Guidance

Any queries regarding how to manage any high-interest credit cards and other debt can be addressed by a financial expert. They can assess the particular circumstances and offer suggestions on how to manage money and consolidate the debt payments.

Employ Available Networks

While there are several resources available to assist one to increase financial literacy, start by looking in our own close-knit circle. We may have close friends, relatives, or a CPA who can provide advice or insight on how to advance financial literacy.

Budget Knowledge

A crucial part of financial knowledge is budgeting. We can reduce or eliminate our debt, save money, and make plans for the future by learning to make and stick to a budget.

Aware of Credit

We must first comprehend credit in order to use it wisely. One should be familiar with the following key credit concepts:

- What makes credit so crucial
- What factors determine your credit score?
- How to raise your credit rating

Learning how to pay off high-interest credit card debt is a necessary component of understanding credit.

Manage Checking and Savings Accounts

Another crucial step in developing financial literacy is opening and maintaining a bank and savings account. These accounts will make it easy to pay expenses and keep money safe. In order to prevent overdraft fees, it's also crucial to learn how to manage the account.

Learn Debt and Loans

Another crucial component of financial literacy is understanding loans and debt. Learning about the various debt types, the solutions for each, and what one should concentrate on paying down first should be a top priority because not all debt is made equal.

Invest for the future

Making a plan for retirement is never too late. Utilize a tax-favored retirement savings vehicle, such as a mutual fund, CPF, or PPF. To ensure one beats inflation while still having money left over to pay for other obligations like a mortgage or student loan, start investing 15% of your income each month.

Recognize the Threat of Identity Theft

When someone commits fraud using another person's personal information without consent, this is known as identity theft. Details such as name, credit card information, Social Security number, or other details relating to an individual identification might be used. Learning how to protect our personal information is the greatest approach to avoid identity theft.

1.4.3 Skills Important for Financial Literacy into Practice

The development of financial literacy abilities should be integrated with all other important skills since this will help learners reinforce the skills they will need once they have learned about personal finance. Financial knowledge is aided by the power to use fundamental abilities to increase decision-making capability and ability to plan ahead that are in line with one's values and goals, allow one to confidently navigate financial institutions, and competence. Below is a list of some examples of these abilities:

- **Critical analysis:** The capacity to evaluate prospective risks critically is at the heart of financial literacy, activities' repercussions and how they fit with one's values, goals, and environment. Establish conditions for a job offer from outside the state, for example, based on a household profile and a possible scenario. Successful outcome based on individual goals and values, as well as a financial comparison of financial aspects as well as non-financial factors to determine whether to accept or reject the offer.
- **Resolving issues:** A household's financial management needs the use of problem-solving and organizational skills in regularly decision-making abilities. When faced with issues from the actual world, students have opportunity for supervised practice in a protected environment as they decide on reasonable standards for a successful look for and evaluate reliable sources as they identify workable answers to the problem at hand and consider

the results—actual or hypothetical—of the chosen course of action. Practice in the classroom can include simple matters like choosing trustworthy and economical transit options, or more complicated issues involving the usage of constrained household resources and prioritizing goals major breadwinner is at risk of being fired or losing their job.

- **Interaction**: Multi-person homes usually need to discuss financial matters. Non-verbal indicators should be taken especially during face-to-face discussions intended to reach consensus. Minimize the chance of misinterpretation by matching verbal terminology. The capacity to communicate concisely and clearly wants and expectations, ask insightful questions to elicit details, and pay attention to (or read the responses) for every sort of business transaction, whether conducted in person, over the phone, or online, requires understanding. Online methods, A role-playing exercise, is one instance of what might be carried out in a classroom.
- **Information processing and analysis**: Smart customers obtain pertinent information from reliable sources, to understand procedures and use data to make decisions. The distribution of a case study concerning personal property being damaged by hail and the necessity to comprehend the ramifications in relation to a linked insurance policy's terms and conditions offer a practical illustration for tenants or homeowners to think about. Students can identify who is accountable for what expenses and for the work required to finish repairs.
- **Self-Awareness:** Being conscious of one's own values, goals, and circumstances is necessary for financial planning. Examining how one's realities and behaviors match up with their preferences and circumstances, offers chances to build on what is effective and change what is impeding growth. As an example of a necessary task for a group project is creating a personal money narrative. During a two-person role-playing exercise centered on creating a monthly budget or significant expense plan, partners are able to read one another's financial histories. Observing contrasts and similarities, they make a spending plan that satisfies the needs of all parties while achieving the goal.
- **Navigational System:** Every commercial transaction involves the capacity to follow instructions or to carry out standardized procedures. Teachers should think about utilizing the Federal Trade Commission's online resources. Investigating various active fraud schemes as a commission. Then, students can locate data to produce a personal checklist for important steps to take if you become a victim of fraud or data theft.

- **Flexibility and openness to learning**: People must make comparable financial decisions, all of their lives, situations and trends that change, such as an increase or decrease in the need to modify spending plans arises as a result of household members, employment changes (beginning or stopping), or retirement, insurance policies and other methods of money management. Students may receive a genuine or fake scenario including job losses or firm closures, and then implement or suggest a strategy to get ready for the modification, such as modifying personal spending goals and acquiring data regarding employment searches and possibilities for training.

1.4.4 Advice for Educating Students in Financial Literacy

- **To make the experience relevant, get to know the students**: Plan your activities with practicality, and alignment with learners' capacities and impending choices and actions in the introduction. Survey the group to determine their skill levels, relevant experiences, and attitudes, and introduce new financial ideas toward specific subjects. Where possible, incorporate everyday encounters and research topics into debates and learning experiences. Gaining insights by employing a Know-Want to Know-Learned technique about what students already know and what they'd like to learn, and it recommends more possibilities for students to consider what they have discovered.

- **Respect privacy and safeguard personal data**: Some students might feel awkward talking about private financial difficulties. Others might consider class talks to be too information heavy. Before discussing personal financial matters, establish limits and ground rules about what information should be made public in class and what shouldn't. Decide when to utilize fictitious data for a group talks or when students may utilize personal information for autonomous learning exercises.

- **Use narrative to introduce subjects or to explain complex ideas**: Using a tale to communicate is effective to explain financial principles and set the stage for discussion of personal economic issues. Mock information and tales give students context for discussion and implementation of learning, particularly when going over challenging subjects. It's possible to analyze actions and to foresee potential outcomes and what might occur if story specifics are changed.

- **Be mindful of your words and tone**: In particular when talking about money. Pay attention to how your tone and word choice may be interpreted while discussing management practices or goals. Each student has a unique financial history and set of beliefs. Avoid using language that could be seen as humiliating or condemning in light of socioeconomic circumstances or personal decisions. Encourage language that empowers and inspires. For instance, when considering ways to handle a specific circumstance, if we want to emphasize choices rather than forcing our personal views on others, replace "should" with "could."

IN-TEXT QUESTIONS

4 Prerequisites for financial literacy are ------------and —-----------.

5 Four components of financial literacy are-------, --------, --------, ----------.

6 An idea of expected incomes and expenses is termed as --------.

1.4.5 The "5 C" approach would be used to spread financial literacy and is as follows-

5 Cs	Content	Capacity	Community	Communication	Collaboration

(1) Content

- Financial literacy materials for instructors, students (both academic and extracurricular), young adults, women, Micro Small Medium Enterprises (MSMEs) (new entrants at work), senior citizens, people with disabilities, those who are illiterate, etc.

(2) **Capacity**

- Enhance the abilities of various intermediates who can help people learn about money.
- Create a "Code of Conduct" for those who deliver financial education

(3) Community

- Maximizing the benefits of **Community** led financial literacy model
- Develop community-led strategies for effectively and sustainably distributing financial literacy

(4) Communication

Through appropriate **Communication** Strategy,

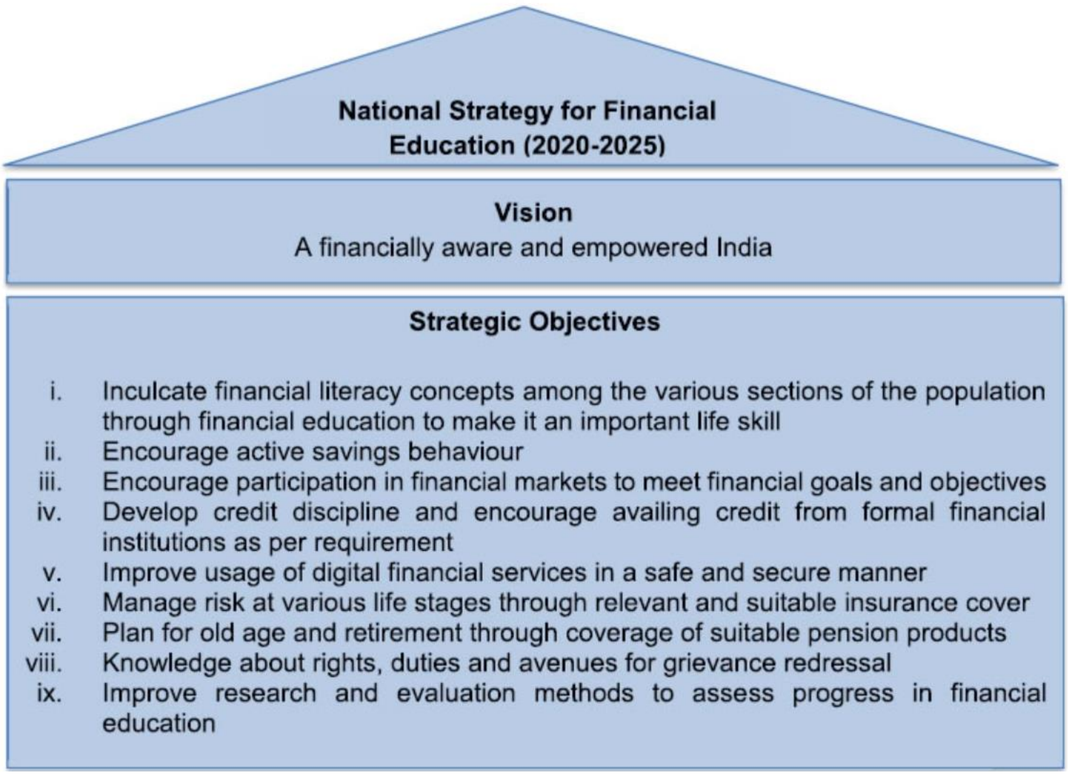
- Use technology, media outlets, and creative communication methods to spread financial education messages.

- Choose a specific time of the year to widely spread financial literacy lessons.
- Utilize more visible public spaces, such as bus stops and train stations, to effectively spread messages about financial literacy

(5) **Collaboration**

- Improving **Collaboration** among various stakeholders.
- Creation of a dashboard of information
- Integrate financial education topics into the curricula of several professional and vocational courses (offered by the Ministry of Skill Development and Entrepreneurship (MSD&E) through Sector Skilling Missions and programmes similar to B.Ed./M.Ed.
- Include the spread of financial education in a number of ongoing programmes.
- Streamline other stakeholders' efforts to promote financial literacy.

Figure 1: Vision & Strategic Objectives of NSFE (2020-2025)



For Enhancing financial education, the following focus areas have been identified:

- Even though there has been progress throughout time, more has to be done to increase women's financial literacy.
- East, Central, and North Zones require additional focus.
- India's rural areas require special care.
- Greater financial education measures are required for the group with lower education.
- The "50 and over" age group needs additional financial knowledge.

1.5 SUMMARY

In conclusion, having a solid grasp of financial principles can help individuals navigate the financial environment, manage their risks, and stay out of financial problems. One can live a stress-free life by developing financial literacy, attaining financial goals, safeguarding oneself in an emergency, securing the future of family, and creating retirement plans. Any advancement in financial literacy will have a significant effect on people's ability to support themselves in the future. Consumers are now expected to bear more of the responsibility for investment decisions in their retirement accounts, all while having to understand more sophisticated financial products and options, making it even more important that they understand fundamental financial concepts. Financial literacy is a difficult skill to perfect, but once attained, it may significantly lessen life's worries.

Activity-3

Mr. Rohan is a college student and has a savings account in a bank. He wants to withdraw money from the bank through an ATM card. He is using the ATM card for the first time for money withdrawal. He seeks your advice for safe use of ATM cards. What are the Do's and Don'ts you will suggest to Mr. Rohit.

1.6 SELF-ASSESSMENT QUESTIONS (SHORT ANSWER QUESTION)

Q.No. 1 Define Financial Literacy

Q.No. 2 What is Financial Management?

Q.No. 3 What are Financial Decisions?

Q.No. 4 Explain budgeting

Q.No. 5 What are debts and savings

Q.No.6 Define borrowings

Q.No.7 Explain the concept of Financial Education.

Q.No.8 Different type of Investment options

Q.No. 9 Objective of financial education for everyone

Q.No. 10 Concept of Taxation

Long answer questions

Q.No. 1 "Financial literacy is the ability to understand financial concepts and make informed decisions about money". Discuss Financial Literacy in view of the above statement.

Q.No. 2 Write a note on the need for and importance of financial literacy.

Q.No. 3 What are the prerequisites for financial literacy?

Q.No. 4 Define the Numerical and Communication Ability required for financial literacy. Q.No.5 Discuss the meaning and scope of financial literacy.

1.7 GLOSSARY

Finance: Related to money

Budget: A projection of income and costs for a given future time period

Savings: Unused funds that a person has saved up

Debt: The sum of money you owe to another person.

Investments: The act of investing money in a bank, company, property, etc.

Decisions: A choice you make after considering a range of options is referred to as a decision.

Prerequisites: Are things that must happen or exist in order for something else to occur.

Resources: Money or other things that are readily available.

1.8 ANSWERS TO IN TEXT QUESTIONS

1	Basic financial concept
2	Finance
3	Financial Literacy
4	Level of education and Numerical and Communication Ability
5	Budgeting, Debt, Saving and Investing,
6	Budget

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LESSON-2

VARIOUS FINANCIAL INSTITUTIONS – BANKS, INSURANCE COMPANIES, POST OFFICES; MOBILE APP BASED SERVICES

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STRUCTURE

2.1 LEARNING OUTCOMES

By the end of this chapter, learners will be able to:

- Understand the concept of Financial Institution (FI) and its Importance
- Learn the categorization of Various Financial Institutions, their Importance and new schemes initiated by the Government in the Banking sector, Insurance sector and Postal sector.
- Be aware of the Mobile Apps, their Importance and apps used in sectors.
- Gain the need of availing various Financial Services

2.2 INTRODUCTION

In the first chapter, you learned the necessity for financial literacy and the basic requirements for attaining financial literacy. In the second chapter, you can learn how to save money well by taking advantage of the services offered by different financial institutions. "Financial Intermediaries" is another name for financial institutions. The lessons aim to comprehend the role banks, insurance firms, and post offices play in the modern era. As business is done online, the operations of financial institutions are undergoing a profound transformation due to this trend**. In addition, the widespread availability of mobile phones has made it easier for financial institutions to conduct business using this means of communication.**

2.3 FINANCIAL INSTITUTION (FI)

Various financial institutions play the role of intermediates in the financial system. They act as middlemen, providing services to customers who are both savers and investors. The term "Financial Institutions" refers to a diverse group of organizations that conduct business within the financial services industry. These organizations include banks, insurance companies, post offices, and many more.

Financial institutions play the role of intermediaries, which is essential to the efficient operation of the financial system. It takes deposits from one group of customers (savers) and then lends those monies to another group of consumers (borrowers). It collects the savings generated by the excess units and invests them in productive activities that guarantee a higher rate of return. Additionally, financial institutions offer their services to individuals, businesses, and governments seeking guidance on various issues, ranging from reorganization strategies to diversification plan recommendations.

Importance of Financial Institutions

- **Promotional activities**

  Financial institutions facilitate innovation by providing venture capital, particular capital and seed capital to new and technically skilled entrepreneurs.

- **Infrastructural facilities**

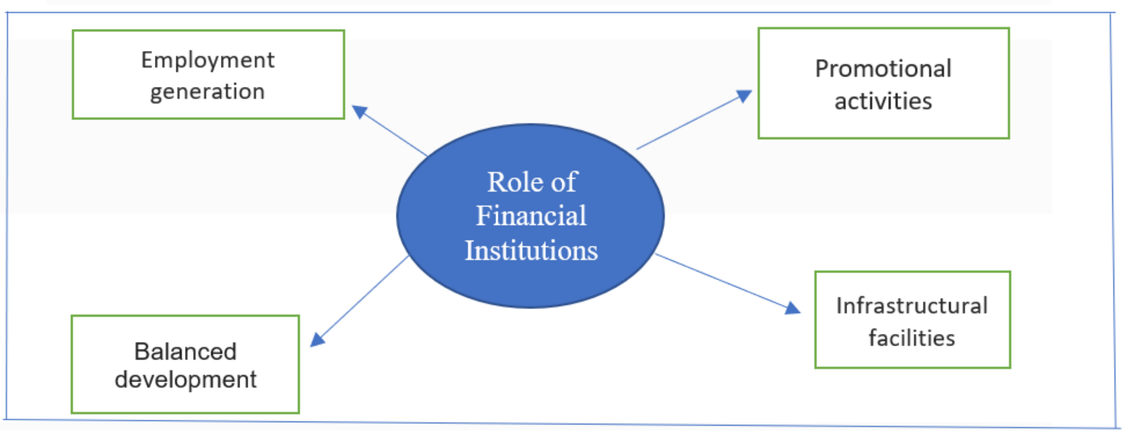
  Financial institutions also offer basic infrastructural facilities needed to develop and promote lucrative ventures. Infrastructural facilities create industrial estates, tech parks, roads and water etc.

- **Balanced development**

  Expanding banking activities to rural and semi-urban areas. The banks have enabled the transfer of surplus capital from the developed regions to the less developed areas where it is scarce and most needed. Allocation of funds between different parts promotes economic development in underdeveloped regions of the country.

- **Employment generation**

  Channelizing the funds for investment, building industrial facilities, and accelerating industries generate employment for the educated and qualified people of the state.



2.4 FUNCTIONS OF FINANCIAL INSTITUTIONS

The main functions of the Financial Institutions are as follows:

- **FI is an intermediary to convert a short-term liability into a long-term investment.**

Short-term debt, also called current liabilities, are to be paid off within a year. Long-term investments are stocks, bonds, and mutual funds. For example, Insurance companies operate on the principle of shared risk. Therefore, customers make a payment known as a premium to the insurance provider, which assumes the risk and is responsible for settling any damage claims. The insurance company is responsible for calculating the premiums so that the total amount it receives from its customer is sufficient to pay for the limited number of damage claims and additional funds remaining for administration and profit. The insurance company calculates the premiums in such a way that the total amount received from all of its customers is sufficient to pay for the limited number of damages.

- **FI helps in the conversion of a risky investment into a risk-free investment.**

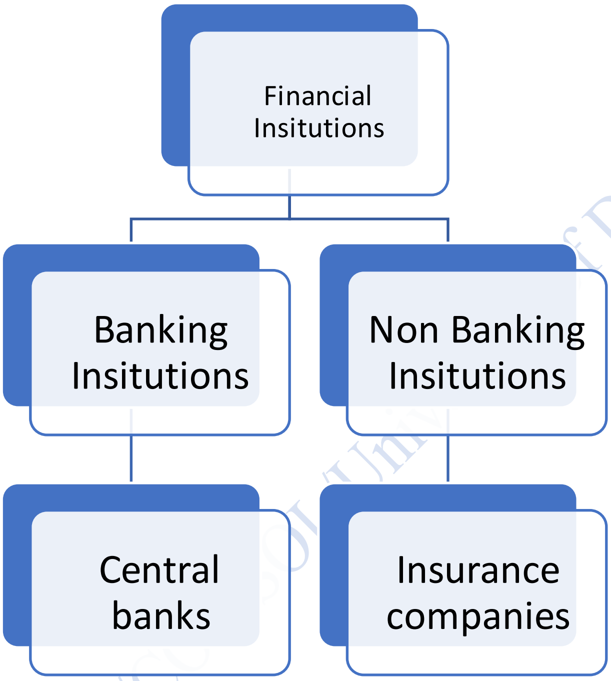
FI transforms a risky investment into one that doesn't have any risks. In finance, Risk is the possibility that an event or investment may yield less than expected. All investments carry some degree of Risk. Namely, stocks, bonds, and funds can lose value, which makes a risky investment. However, a risk-free asset has an inevitable future return—fixed deposits, Recurring Deposits, and post office deposits. For example, if a customer requires a loan and has a significant guarantee, Bank offers loans at low-interest rates & flexible tenure. On the other hand, if a customer has a deposit, the RBI bank may offer them a high-interest rate, and if the customer has a significant guarantee, the Bank may offer them a small loan.

- **Financial institutions also provide a whole range of services to entities**.

Lenders can also ask for routine Management Information System (MIS) reporting to minimize credit risks. In this case, the lender will ask the borrower to send predetermined financial statements regularly. The bank may monitor the borrower's current financial situation and capacity to repay the loan. Lenders can also request periodic Management Information System MIS reporting to manage credit risks. In this scenario, the borrower will be asked to submit predetermined financial statements to the lender periodically. The bank may monitor the borrower's current financial status and ability to repay their loan.

2.5 CATEGORISATION OF VARIOUS FINANCIAL INSTITUTIONS

Basically, these financial institutions were categorized into two categories: Banking institutions and non-banking institutions



Expenses often crop up without warning, and borrowing money at the eleventh hour can be challenging. Consider a situation where your friend needs cash for medical treatment in the middle of the night. At this hour, Other friends are probably asleep. Swap your debit card and help him. Having your savings means you can access the help you need when you need it. Most importantly, it means you can live life comfortably on your terms. So what is the best way to save money? Once you have built up a good corpus of funds, then where to invest? Who will guide the right investment strategy and tools according to your capacity and goals?

2.5.1 Banking Institutions

Banks provide financial services like withdrawals and deposits, mortgages, and various types of loans to retail and commercial customers. Banks also facilitate monetary transactions through charge cards, electronic funds transfers, and currency conversion. Banking Institution plays a vital role in the economic development of the country. The stability of the economy is closely related to the growth and soundness of its banking system

Importance of Banks

- **Encourage people to save money**

  Bank attracts depositors by introducing safe and attractive deposit schemes and providing a higher interest rate. These accounts are opened as per the requirement of customers, such as current accounts, fixed deposit accounts, saving accounts and recurring accounts.

- **The facility of capital transfer**

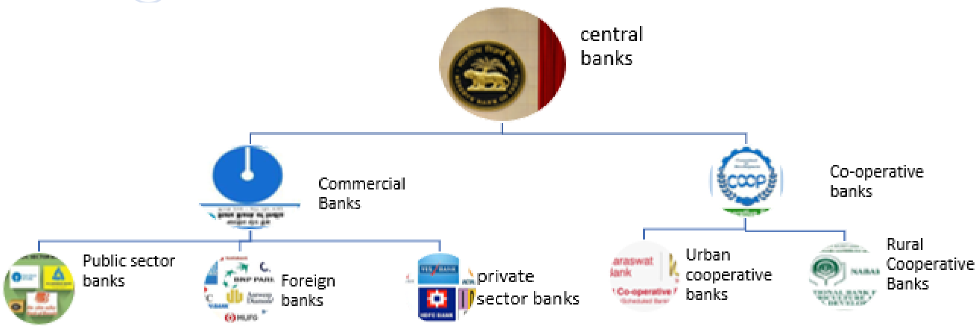
  Bank sends money from one place to another quickly at less rate. They mail it through drafts, cheques and digital forms for the developing economy.

- **Finance trade, commerce, industry, and agriculture**

  Banks collect small and significant savings of the country and use them for production. It helps in the economic development of the country. Banks provide timely financial assistance to traders and industrialists. Large-scale transactions would only be possible with bank savings of people deposited in the bank. It is used as credit for industries.

- **Aid to Government**

  Banks provide financial assistance to the government for various economic planning and development schemes by purchasing government bonds, certificates, debentures, etc.



Banking structure can be categorized based on their ownership and services they offer:

Central Bank

The central bank of India is the (RBI). It is responsible for managing the nation's currency to ensure an adequate supply of genuine notes. RBI acts as a government banker and implements monetary policy as the central bank.

The functions of the RBI are as follows:

- The bank regulates supply of the Indian rupee.
- It also looks after the central government’s money.
- RBI is the Issuer of notes. It prints currency notes except 1 rupee note.
- RBI controls all the banking functions of the central and state government of the country.
- Adviser of the government on monetary policy.
- It is the Banker’s bank.

Regulator of the financial system of the country. It controls inflation in the economy

1. Commercial Banks

Commercial bank accepts deposits, offers to check account services, does business, personal, and mortgage loans, and offers essential financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses. Their primary function is to accept deposits and grant loans to the general public, corporate and the government.

Commercial banks are three types:

a) Public sector

Public sector is type of commercial bank that the government of a country nationalizes. These banks operate under the guidelines of the Reserve Bank of India (RBI), the central bank. These are the nationalized banks Majority of stakes in these banks are held by the government. Regarding volume, SBI is the largest public sector bank in India, Punjab National bank etc.

b) Private sector

It is the second commercial bank in which private businesses and individuals hold a significant share of capital. These banks are registered as companies with limited liability. These include banks in which private shareholders hold a significant stake or equity. RBI rules and regulations are mandatory for private-sector banks. Like ICICI bank, HDFC bank etc.

c) Foreign banks

Foreign banks are owned and managed by foreign promoters. Their headquarter is in a foreign country, but they operate in different countries, namely, HSBC, Standard Chartered Bank etc.

2. **Cooperative Banks**

A cooperative bank is a small-sized financial entity whose members are the bank's owners and customers. A cooperative society is formed by small groups with common interests. Cooperative banks work based on mutual benefit. They are regulated by the Reserve Bank of India (RBI) and are registered under State Cooperative Act.

There are two types of Cooperative Banks:

1. Urban

"Urban Cooperative Bank" refers to any cooperative bank in an urban or semi-urban center (UCB). These banks are established to provide financing for smaller businesses. One of the most critical distinctions between UCBs and commercial banks is organizational ownership.

2. Rural

Primary Agricultural Credit societies that mainly give only agricultural loans are permitted to use the word 'bank 'in their names. In some states, primary agricultural credit societies are called 'Rural Co-op Bank". 'They cannot have accounts with checkbooks. They should accept deposits only from members.

New Government Bank Schemes

The Reserve Bank of India encouraged commercial banks to create exclusive financial solutions for economically disadvantaged people. As a result, many know about essential financial services like savings accounts, personal loans, crop loans, microfinance, etc. Credit and debit cards are also important.

Banks were advised to provide low-income groups with cost-effective credit cards due to their lack of instant credit. Their innovative financial products include:

- **General Credit Cards (GCC)**- Semi-urban and rural banks provide GCCs up to Rs.25,000.

- **Fintech (fintech)**-software, mobile apps, and other technologies—improves and automates traditional finance for organizations and consumers. Fintech start-ups have offered low-cost financial services and products. Customers save money and can use it for other needs with this technology.
- **Bank-led AEPS-** allows Aadhaar-enabled bank customers to use a Business Correspondent to complete essential financial operations like balance inquiries, cash deposits, cash withdrawals, and remittances.

In Text Questions

1. Financial institutions move money from
   1. Borrowers to savers 2. Buyers to sellers,
   3. Savers to borrowers 4. Sellers to buyers
2. Which is not an example of a financial institution?
   1. Commercial banks, 2. Investment banks,
   3. Insurance companies, 4. The Federal reserve
3. RBI encourages provision of affordable financial services like
   A) zero-balance
   B) no-frills bank accounts
   C) access to payments and remittance facilities
   D) All of the above
   E) None of these
4. Banks attract funds from savers by offering --------- on savings,
   1. Profits
   2. Revenue,
   3. Interest,
   4. Benefits
5. Banks use depositors' savings to earn -------- by lending the savings to borrowers.
   1. costs,
   2. Profit /Revenue /Income,
   3. credit
   4. Demand

2.5.2 Insurance Sectors

Activity-1

The fact that our life is inherently risky. Consider the situations where the family bread earner suddenly passes away, a family member gets a fatal disease requiring immediate medical attention, or his life savings get stolen.

What would he do in such cases if he had not planned for them?

Insurance

Insurance is a contract between two parties, i.e., the individual and the insurance company. The individual is called “insured”, and the insurance company is called the “insurer”. The insurance company assures to make good the insured’s losses on the accident.

Insurance Companies

The insurance company collects premiums from the customers and uses that pool of money to pay the claims. It helps reduce financial disaster as the costs are shared among many people. It spreads or transfers risks. Many different kinds of insurance policies are available in India. Mainly, insurance products are Life insurance products and General insurance products. General insurance products cover a wide range of risks, such as health insurance, travel insurance etc.

Importance of Insurance Companies

- **Spreads Risk**

Insurance companies promise to safeguard investors' lives and property. But in addition, insurers protect people and businesses.

- **Assurance**

The assets and financial risks associated with private and public sector investments that promote economic growth are covered by insurance products. For example, a significant loss of merchandise without insurance is expensive.

- **Legal Prerequisites**

In many circumstances, the law mandates the purchase of insurance. For example, it could be essential to buy fire insurance in specific situations, including when items are shipped via freight or when a new public site is opened. As a result, an insurance provider will help us fulfil these needs.

- **Capital Formation**

Policyholders' premiums are pooled to serve as the insurance firm's initial investment capital. This amount can invest to better use in the company by funding projects that generate income.

Like any other financial institutions, insurance companies also generate savings from the insurance sector within the economy. The insurance sectors based on the various Principle. **These Principles are:**

1. **Principle of Trust**

The insurance contract requires mutual trust. Therefore, it is the responsibility of the consumer to provide the insurance company with all the relevant information. Cancellation of the contract is possible in any fraudulent activity or material misrepresentation.

2. **Principle of Insurable Interest**

Under this principle, the insured must be interested in the policy's subject matter. For example, an insurance firm will not offer a policy without insurable interest. In addition, the insured must have owned the subject matter when the contract was signed and when the accident occurred to be eligible for an insurance payout.

3. **Principle of Compensation**

Compensation means Indemnity against loss or damage. Indemnity means loss or damage protection. The compensation principle states that the insurance company cannot compensate an insured for more than their economic loss. Therefore, this sort of insurance reimburses the insured for the actual loss.

4. **Principle of Substitution**

The substitution principle allows the insured to collect the amount from a third-party responsible for the loss. In addition, it will enable the insurer to pursue legal action to manage the number of damages. For example, let Dikshit get injured in a car accident caused by the irresponsible driving of a third party. In this case, his insurance company will reimburse him and file a lawsuit against the third party to recover the money paid as a claim.

5. **Principle of Contribution**

If more than one insurer covers the same issue, other than life, it will split the actual loss among the insurers.

New Government Insurance Schemes

The Government plays a prominent role and supporting sustainable production in the agriculture sector, ensuring access to financial services, announcing the Schemes available to people in the age group 18 to 70 years and providing an insurance -cum-pension scheme that provides security to senior citizens. These are:

Pradhan Mantri Fasal Bima Yojana (PMFBY) and Restructured Weather-Based Crop Insurance Scheme (RWBCIS.)

The Government started the Pradhan Mantri Fasal Bima Yojana (PMFBY) and the Restructured Weather-Based Crop Insurance Scheme (RWBCIS) to help farmers by giving them affordable crop insurance that protects their crops from all natural risks. The objective of the following:

(i) To Provide insurance coverage and financial assistance to the farmers if any **crop fails** due to natural **disasters,** pests, and diseases.

(ii) To Stabilize the **farmers' incomes**

(iii) To ensure **the continuation of** farming.

(iv) To ensure that the agricultural sector receives credit.

The Scheme is implemented through a multi-agency framework by selected insurance companies under the overall guidance & control of the Department of Agriculture, Cooperation & Farmers Welfare (DAC&FW), Ministry of Agriculture & Farmers Welfare (MoA & FW). Government of India (GOI) and the concerned State in coordination with various other agencies.

- **Pradhan Mantri Jan Dhan Yojana (PMJDY**)

The Pradhan Mantri Jan Dhan Yojana is a national financial inclusion mission. It plans for everyone to have financial literacy, use banks, and have at least one primary bank account. It also guarantees loans, insurance, and pensions for everybody. Later, PMJDY also covers accidental insurance for RuPay cardholders. It is available in urban and rural locations, and individuals who open an account will receive an indigenous Debit Card (RuPay card).

- **Pradhan Mantri Suraksha Bima Yojana (PMSBY**)

The schemes protect against accidental death and total disability and offer the convenient option of "auto-debit " to the holder's bank account. The plan will be a one-year cover, renewable from year to year. Aadhar would be the primary KYC for **a** bank account. The program would be offered by Public Sector General Insurance Companies (PSGIC) and other non-life insurance companies in collaboration with banks. Participating banks **can hire** insurance companies to implement the **system** for their subscribers. General insurance companies offer the plan to people between 18 and 70 who work in the public or private sector and have a bank account.

- **Pradhan Mantri Vaya Vandana Yojana (PMVVY)**

The Indian government, through the Life Insurance Corporation of India (LIC), implemented a pension programme that guarantees payments to those aged 60 and up. It was done to secure their retirement and protect their interest income from market fluctuations. The Indian government raised the Pradhan Mantri Vaya Vandana Yojana plan's upper ceiling to Rs. 15 lakhs in the 2018-2019 Budget Speech. The Life Insurance Corporation of India (LIC) provides the program online and offline. The program's main objective is to give senior citizens a regular pension. In addition, the pensioner will receive an assured return of 8% each year for the duration of the policy, which is ten years.

In Text Questions

6. Match the Following:

a) The term "Assurance" is used for	1. Premium
b) "Date of maturity" means	2. Life Insurance
c) Insurance companies collect a certain amount at a specified. time is called.	3. The insurance contracts ends on this day
d) Insurance works on the principle of.	4. Sharing of losses

7. Which of the following is a feature of the Pradhan Mantri Jan Dhan Yojana?
   A) provision of Crop insurance
   B) Accidental insurance
   C) Issuance of Ru Pay with debit cards
   D) All of the above

For more than 150 years, one service has **helped the country to engage in communication and social-economic development**. It has succeeded in touching the lives of people across the country, from delivering mail to accepting deposits and providing retail services like bill collection, sale of forms, etc. However, the services which foster community and educate residents were equally or even more significant than their financial advantages. Do you know which service this is?

2.5.3 Postal Sectors

Importance of Postal Sectors

- **Investment Scope**

The Indian Postal Service offers numerous investment opportunities. Tax implications, investment timeframes, and estimated returns vary by product to meet investor preferences.

- **Safe and Fixed return**

The Post Office savings plans are simple and require little paperwork. They are safe and provide a fixed rate of return because the Indian government governs them.

- **Stable Return**

The Postal Service has plans to carry out over more than 15 years. Therefore, one can diversify their holdings for a guaranteed and stable return through this investing scheme.

- **Financial Services**

The post office provides banking, money transfers, savings, deposits, and retail services like bill collection and form sales to assist the industry and commerce expansion.

- **National Connectivity**

The post office is more than just a location for mailing letters. Its Services have connected and developed the nation.

New Government Schemes of the Postal System

India's postal system is the largest in the world, with 156,434 locations around the nation. The functioning of the Indian Post Office has transitioned from an entirely manual mode to a fully inter-connected mode, and it does s through various channels, including ATMs, the internet, mobile applications, and text messages. The Core Banking Solution, known as CBS, is a component of the India Post office. Consequently, consumers can make inquiries and complete transactions at any time and location. The government has announced that the post office will become a bank called "Post Bank of India." The Central Government officially started the Indian Post Payment Bank on September 1, 2018. (IPPB). IPPB Banks differ from Post Office Saving Accounts (POSA), but it is possible to combine POSA accounts with IPPB bank accounts.

Differences between (POSA)and IPPB bank accounts are shown in the table below:

Parameters	IPPB	POSA
Types of Account	The IPPB offers three savings account – regular, digital and basic.	POSA offers banking and remittance services like any other bank.
Deposits	It is possible to open savings accounts with zero balances.	A minimum deposit of twenty rupees is required to open an account.
Account - minimum balance	Account holders do not need to maintain any minimum balance in their savings account at any time.	Account holders must maintain a minimum account balance of at least Rs 50 per month.
Account - maximum balance	The maximum limit of savings amount is Rs 1 lakh. Any amount above this will	There is no maximum balance limit for the account holders.

	be transferred to the linked POSA account.	
Doorstep Banking	New doorstep banking feature are there.	No doorstep banking feature.
Governing Authority	Reserve Bank of India	Union finance ministry

The India Post Payments Bank (IPPB) recently launched the "Fincluvation Platform" to work with fintech start-ups to find new ways to help underserved and unserved people access financial services faster.

2.6 COMPARISON OF THREE FINANCIAL SECTORS

Difference Between Banks, Insurance Companies and Post Office

Particulars	**Banks**	**Insurance Companies**	**Post Office**
Definition	Banks accept short-term deposits and pay interest on them. They also make short term/long-term loans and charge a higher interest rate.	The threats to life and property may lead to monetary losses. Therefore, it is wise to shift these risks to an insurance firm via insurance.	Post offices offer customers various mailing services, including parcels, letters, and envelopes, as well as mail for government agencies. They take deposits, but they don't give out loans.
Objective	The core activity of a bank is the collection of deposits (savings) from private, corporate, and institutional	Insurance aims at the minimization of losses arising from future risks and uncertainties. It adds certainty of payments	Initially, the post office focused only on delivering mail(post), and later, it started providing an area of other

	customers and extending loans to these same groups. Deposits represent liabilities for a bank, whereas loans extended are the assets on its balance sheet.	to people for happening of uncertain events. Insurance assures the individuals of compensation for losses. It minimizes the risk through proper planning and administration	financial services that as banking, insurance, and investment.
Return	Banks charge high-interest rates to people who borrow money from them, but they pay much lower interest rates to those who put money in the bank. As a result, the disparity between the two interest rates becomes the banks' primary source of profit.	A life insurance policy that provides a regular and guaranteed income to assist in meeting monthly expenses and achieving short-term financial objectives. Moreover, investments in savings plans such as guaranteed returns policies offer investors guaranteed returns.	The interest rate of post office deposits is revised every quarter by the government of India. The interest is calculated quarterly and paid annually. The rate is determined based on the yield on government securities. (G-secs). While post office offers significantly higher interest rates than banks, even at 1 to 2 percent higher rates.
Tenure	Short-term deposits" mature in less than a year, whereas "long-term deposits" mature in more than	Life insurance policies provide investors with protection and guaranteed profits for	The fixed deposit tenure ranges from 7 days to 10 years which can be suitable for short-

	a year. Term deposits with maturities of up to seven years are occasionally available.	a more extended period, typically up to the age of 99. In other words, the position's duration can be increased up to a lifetime. The only restriction is that potential investors must be at least 18 years old	term and long-term investment purposes.
Investment	The minimum amount to start investing in a fixed deposit is Rs.1000. Also, there is no limit on the maximum investment.	The premium for a life insurance plan varies depending on the type of policy and other factors like the policyholder's age, policy value, insured's health condition, etc.	The minimum amount to start investing in a fixed deposit is Rs.1000. Also, there is no limit on the maximum investment.

2.7 MOBILE APPS

Mobile apps have changed the way people do business and how people live their lives. It has opened the door to a new era of flexibility and ease. For example, technologies like blockchain are making banking and financial apps safer. Blockchain eliminates intermediaries for financially independent parties.

Importance of Mobile Apps

- **Fast Services**

  Apps and the internet allow us to complete our work more quickly and efficiently.

- **Trusty worthy**

  Financial mobile apps are safer from unlawful transactions since users must authorize transactions through the app.

- **At all hours**

  During this Covid value-added mobile apps were discovered. As a result, users can maintain control and avoid many unpleasant outcomes even in a global pandemic.

- **Scheduling**

  Intelligent mobile apps enable users to handle finances, insurance, and postal services through transparent transactions.

2.7.1 Mobile App for Banking Sectors

The rapid spread of the mobile phone era has helped banks use this mode for transactions. It cuts paperwork and lines. SBI, ICICI, and others offer mobile banking. In addition, *99# USSD (Unstructured Supplementary Service Data) allows mobile banking for non-smartphone users.

Mobile apps offer:

- Checking balance,
- transferring funds,
- paying bills, and
- ordering cheque book
- Bharat Interface for Money (BHIM) is an app that uses Unified Payments Interface to make it easy and quick to send and receive money (UPI). It lets you send money directly from bank to bank and get money back using a Mobile number or Payment address. The Bharat Interface for Money app is currently available for smart phones that run on Android and can be downloaded from the Google Play store.
- Financial technology companies are making it possible for people in rural areas to use their cell phones to apply for loans or open bank accounts. Some people in rural India have access to mobile internet, so they can use fintech services to get reliable financial services.

Let us learn about some do's & don'ts while performing digital banking:

Do's	Don'ts
• Do not divulge your user ID and password to anyone, • Memorize your user ID and password rather than writing them down • After each session, log out completely and clear your system cache.	• Never use an email message to log in to your banking account; always use the official website • Never reveal personal information to anyone via email, SMS, or phone • Never use the "Remember Password" feature that is offered by browsers.

2.7.2 Mobile App for Insurance Sectors:

Technology has transformed everything, including insurance firms, in recent years. COVID-19 changed every area of the insurance industry, including consumer needs and behavior.

To assure business continuity, the following digital solution has been developed by the company:

- **'i-Serv'**

  During the time of COVID, a new feature called i- Serv was introduced on What's app. This feature allowed users to make video calls in 11 different languages. The customer service app and portal 'Life Assist 'also ensures customers to self-service their policies from anywhere anytime.

- **Smart Document Upload**

  A software allows distributors and customers to upload papers from their phones, improving e-document collecting.

- **i-WorkSafe App**

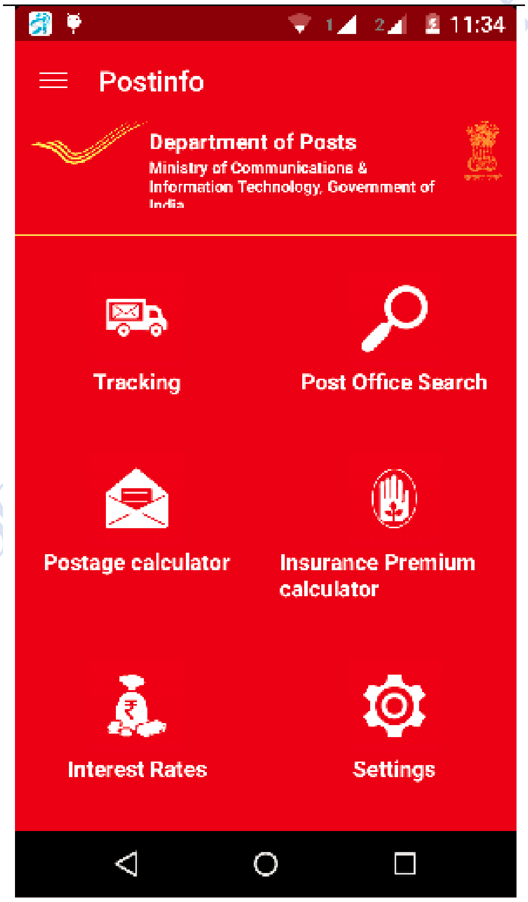
  The i-Work Safe app for office social distance and the Arogya Setu app for health monitoring have been connected to provide a system of alerts and notifications to enhance employee well-being and safety.

- **Instant Call Patch for Tele-Medicals**

  The tele-medical interviews are conducted by connecting the customer and the physician over a phone conversation, which is made possible by this system.

2.7.3 Mobile App for Post Office sectors

Department of Posts customers and Branch Post Office Savings Account holders can use Mobile Banking. The Centre for Excellence in Postal Technology in Mysore made a smartphone app (Post Info) for citizens. The app keeps track of things like e-Money orders, registered items, parcels, and speed post, among other things. Post Office pin code, contact information and addresses, postal postage search, calculator, postal life and ruler, life insurance, India Post, premium calculator, interest, calculator for small savings.



2.8 NEED OF AVAILING OF FINANCIAL SERVICES FROM BANKS, INSURANCE COMPANIES AND POSTAL SERVICES

Financial inclusion provides banking and financial solutions and services to all members of society without bias. Its primary objective is to ensure that no community member is excluded by denying them access to essential financial assistance regardless of their ability to pay. In addition, financial inclusion provides financial support without hidden fees or charges.

2.8.1 Banking Sectors

The Reserve Bank of India issued a directive to all banks requiring them to offer Basic Saving Bank Deposits (BDSD) accounts to those members of society who are economically disadvantaged. No minimum balance or minimum deposit requirements are imposed on account holders, sometimes known as "no frills" accounts. Customers with these accounts can access cash withdrawal options at bank branches and ATMs. In addition, they can use electronic payment channels to receive money from other people and send it to other individuals.

The RBI asked banks to simplify KYC processes for low-income individuals to open bank accounts under Rs. 50,000. Since most low-income people have Aadhaar cards in their names, banks have been asked to accept them as identity and residence evidence.

2.8.2 Insurance sectors

Due to the absence of bank branches in rural regions, the RBI has mandated that all bank insurance plans include medical emergencies, hospitalization, illness and treatment, and medical care necessary in the future.

Insurance aims to safeguard a person and his family from financial loss in the event of an accident. Regular investments help build wealth or savings for the future. The contract between the insured and the insurer is known as the insurance policy. The insurance policy specifies the terms, conditions, and situations. The insured person pays regular premiums, some of that money goes toward life insurance, and some go into a savings or investment plan. On the maturity date of insurance policy or on unforeseen event the insurer will pay the promised sum to the insured or their specified beneficiaries

2.8.3 Postal Sectors

Post offices render two types of services. First, they are Mail services: Mail services refer to the services rendered by post offices for written communication. And Financial services or facilities: The post office provides various financial services. Namely Monthly income scheme, Recurring deposit account, Time deposit Senior citizens savings scheme, 2004. Due to the widespread presence of post offices around the nation, the Post Office Schemes are open to investors from rural and urban areas.

As of 31.12.2021, A New India (DARPAN) program was launched under the Digital Advancement of Rural Post Office. The Department of Posts has equipped Branch Post Offices nationwide with SIM-based handheld devices for conducting online Postal and Financial transactions. The fundamental objective and mission are to provide the most accessible, affordable, and trustworthy IPPB for the average person, promoting financial inclusion by removing barriers and lowering the cost of obtaining banking services.

2.9 CASE STUDY

Read the following text and answer the following questions on the basis of the same: Mr. A. Bose is running a successful business. Mr. Bose is the owner of R. K. Cements Mr. Bose decided to expand his business by acquiring a Steel Factory. This required an investment of Rs. 1 crore. To seek advice in this matter, he called his friend Mr. T. Ghosh who advised him a to take a loan @12%. Employing more of cheaper debt may enhance earnings of the firm. Mr. Ghosh also suggested him to take loan from a financial institution as the cost of raising funds from financial institutions is low. At the same time, the interest on loan is a tax-deductible expense for computation of tax liability. After due deliberations with Mr. Ghosh, Mr. Bose decided to raise funds from financial institutions. he checked bank balance on mobile through installed app. He took loan and expanded his business; therefore, production turnover was outstanding and outperformed the expectations. Being successful in the venture, he transferred Rs1,1,50,000 to the regular saving account of IPPB. **He also took an insurance policy and declared that he is diabetic**.

Q.1 Which important function of Financial Institution is addressed here? and enumerate it

Q2. Identify Which principle of insurance has been followed and also explain the other principle of insurance.

Q.3 Explain the features of IPPB account.

Q4 What is the maximum limit of IPPB account and where excess amount is transferred (if any)?

Q5 Which Mobile app he has used and explain the importance of mobile app?

2.10 SUMMARY

Financial institutions are the key institutions which provide funds for economic activities. Financial institutions accelerate industrial growth by granting finance, project development and consultancy. The central bank of India, i.e., Reserve Bank of India, is the apex institution that controls the entire financial market. The Core Banking Solution (CBS) Project brings ATM Banking, Internet Banking, Mobile Banking and Phone Banking facilities to the Post Offices Savings Bank (POSB) customers to perform transactions 24×7 in ATMs. The working has moved from completely manual mode to a fully inter-connected manner through which Any Time Any Banking is possible. Insurance aims to safeguard a person and his family from financial loss in the event of an accident. The legal or formal contract between the insured and the insurer for the insurance is known as the insurance policy. Accounts can be opened instantly through their respective mobile apps by providing details like Aadhaar numbers with KYC verification.

2.11 GLOSSARY

The financial system: is the process by which money flows from savers to users.

Bank: an institution for receiving, keeping, and lending money.

Central bank: a bank that can lend to other banks in times of need

Interest: the price paid for the use of borrowed money.

Principal: the amount of money borrowed.

Default: failing to pay back a loan.

Mortgage: a specific type of loan that is used to buy real estate.

Interest: the price paid for the use of borrowed money.

Insured: The person or organization that is covered by insurance is called the insured.

Insurer: A person or company that promises to pay compensation for an insurance risk, is called the Insurer

Premiums: An insurance premium *refers to a specific amount paid periodically by the insured individual.*

Insurance Regulatory and Development Authority of India (IRDA)- The statutory body promoting and regulating various types of insurance companies in India.

2.12 ANSWERS TO IN TEXT QUESTIONS

1. Savers to borrowers
2. The Federal Reserve
3. All of the above
4. Interest
5. Profit/Revenue/Income
6. a) Life Insurance

   b) The Insurance contract ends on this day

   c) Premium

   d) Sharing of Losses
7. Accidental Insurance

Activity-2

Insurance is the best alternative.

Explanation: Insurance provides a sense of security for such unexpected incidents. In simple words, insurance means you pay a lump sum amount to get protection against an unforeseen accident of a large magnitude.

2.13 SELF-ASSESSMENT QUESTIONS

Short answer questions

Q. No. 1 What are the main types of financial institutions? Explain it.

Q. No.2 What is Mobile Banking?

Q. No.3 Are there any disadvantages to Online or Mobile Banking?

Q. No.4 What is the aim of Mobile App?

Q.No.5 Post office offers very attractive products for all types of customers. Do you agree with this statement? Validate your arguments with points.

Long answer questions

Q.No.5 Explain the role of financial institution in the economy?

Q.No.6 Why are non-banking financial companies valuable to the financial system?

Q.No.7 Why mobile app technology require in banking and insurance sector?

Q.No.8 What are the New Insurance schemes taken by the Government?

Q.No.9 What are the importance of Mobile App?

Q.No.10 Do you think that the while performing digital transactions, some steps should be kept in mind. Explain it

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LESSON-3

FINANCIAL PLANNING AND BUDGETING

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STRUCTURE

3.1 LEARNING OBJECTIVES

The objectives of this chapter are to enable students to understand:

- The difference between need, wants and how unlimited wants can be met with scarce resources. The importance of Financial Planning and Budgeting
- How a household, a businessman, and a nation make a budget.
- Different avenues of savings

3.2 INTRODUCTION

Students have recently learned about financial literacy and the skills required for it. An overall sense of financial well-being and self-confidence are derived from a confident grasp of ideas like saving, investing, and debt. Very well, the numerous kinds of financial institutions were understood by the students. A company that deals with financial and monetary transactions such deposits, loans, investments, and currency exchange is known as a Financial Institution (FI).

Students will learn the fundamentals of economics in this chapter, as well as how to balance their boundless demands with finite resources. They will need to budget their money and prepare their wages for this. Students will gain knowledge of the financial planning process. They'll learn how to create their own personal, family, and business budgets. In the last topics students have learnt about Financial Literacy and ability needed for the same. It is the confident understanding of concepts including saving, investing and debt that leads to an overall sense of financial wellbeing and self-trust. Students very well got the understanding of different types of Financial Institutions. A Financial Institution (FI) is a company engaged in the business of dealing with financial and monetary transactions such as deposits, loans, investments, and currency exchange. Avenues for savings from surplus will help them to park their funds ideally.

3.3 WANTS, NEEDS AND SCARCITY OF RESOURCES

A person's physiological, individual, or socioeconomic needs are determined by what they need to survive and function. The modern urban guy needs transportation since his place of employment is too far from where he gets his food and other daily essentials.

Contrarily, wants are intended to meet our needs. You might be able to drive your own car, take public transportation, or bike to work. Even if all of the options are viable, one prefers an automobile to meet their transportation needs. With limited resources everyone wants to fulfill its unlimited wants, whether it is an individual or firm or government. To satisfy his unlimited wants an individual has to rank his preferences. A firm has to choose the cheapest technology for its production whether labor intensive or capital intensive. Government has to make a choice between consumer goods or capital goods depending on resources and demand of the public. Ultimately everyone can't buy or produce everything together. Needs can be satisfied but not wants.

3.3.1 Economic View of Needs and Wants

The fictitious economic man, who behaves logically to maximize his ability to consume products and services that bring him the largest degree of utility or satisfaction, is used to illustrate the economic understanding of needs and wants. The search for our economic guy is endless. According to economic theory, needs may finally be met for a while, but wants are never.

For instance, a one-bedroom apartment satisfies our housing needs and wants, but after getting married, one wants a townhouse. When the first child is born, the desire shifts to a three-bedroom house. Even while the first house satisfied one's demand for family dwelling, one may later desire a home with a few extra bedrooms and a pool.

3.3.2 Scarcity of Resources

In economics, the term "scarcity" describes a situation where there is a limited supply of a resource and a high demand for it. Consumers are being forced by scarcity to decide how to allocate resources to satisfy as many of their wants and requirements as feasible. People are forced to choose between their desires and limited resources (resources). This calls for the ability of even the resource owner to prioritize the alternative uses to which a certain number of resources can be placed. The social science of economics examines the processes of production, distribution, and consumption. It involves making choices on the distribution of finite resources in order to maximize their usage and satiate human desires and requirements.

The root of all societal economic issues is the tension between limitless desires and finite resources. People are forced to choose between what they want to gratify and what they want to give up as a result of this conflict. Every person must prioritize their desires in order to realize them within their means. The phrase "resource scarcity" is used in a relative sense and relates to the possible applications for the resources. Pure absolute scarcity is economically meaningless.

The resources can be used in other ways, though. A teacher may work for a university or a school. On a plot, wheat or rice can be planted. This results in a financial issue.

Activity-1

Mr. X is an individual who earns Rs. 50000, wants to buy branded clothes, eat good food in restaurants, and wants to give the best education to his children. His resources are limited but his wants are unlimited. So how is he going to satisfy his wants with limited resources?

In Text Questions

1. Wants are meant to fulfill our —---.
2. Resources are —---.
3. Wants are ——---.

3.4 DEFINITION OF FINANCIAL PLANNING

Financial planning is defined as the act of evaluating the necessary capital and figuring out its competition. It is the process of establishing a company's financial strategy with regard to raising, investing, and managing capital.

3.4.1 Goals for Financial Planning

1. Calculating the necessary capital - This depends on a number of things, including working capital costs, fixed investments, advertising costs, and long-term planning. It's important to consider both short-term and long-term capital needs.
2. Determining Capital Structure - The composition of capital i.e., the relative type and percentage of capital needed for the business, is known as capital structure. This covers choices for short- and long-term debt-to-equity ratios.
3. Developing financial policies pertaining to borrowing, lending, and cash management.
4. A financial manager makes sure that limited financial resources are used as efficiently and affordably as possible to maximize returns.

3.4.2 The Importance and Need of Financial Planning:

Establishing objectives, rules, procedures, programs, and budgets for a company's financial activities is known as financial planning. This guarantees a sound and suitable financial and investment policy. The significance is best expressed as follows:

1. The necessary finances must be raised.
2. In order to maintain stability, financial planning helps to guarantee a proper balance between cash inflows and outflows.
3. Financial planning makes it possible for financial service providers to invest with ease in businesses that perform financial planning.
4. Financial planning enables the development of growth and expansion strategies that support the long-term viability of the company.
5. With adequate cash, it is simple to overcome the risks caused by shifting market patterns thanks to financial preparation.
6. Financial planning aids in lowering the uncertainties that may impede a company's expansion. This contributes to the company's sustainability and profitability.

Explained with the following Example:

- Each chocolate is sold for $4 and costs $1 to make in materials.
- You plan on selling 10,000 chocolates in year 1, 15,000 chocolates in year 2, and 25,000 chocolates in year 3. Sales projections after year 3 are difficult to make, but you know that they will not be lower than 25,000 cones per year.

- Your lease for the business location is $20,000 annually, and your lease for the chocolate equipment is $10,000 annually.
- You plan on hiring part-time staff to help you during peak season. You assume that this would cost $10,000 annually for years 1 and 2 and $20,000 in year 3.
- Your overhead, legal and accounting costs amount to $10,000 in the first year and $5,000 per year in subsequent years.

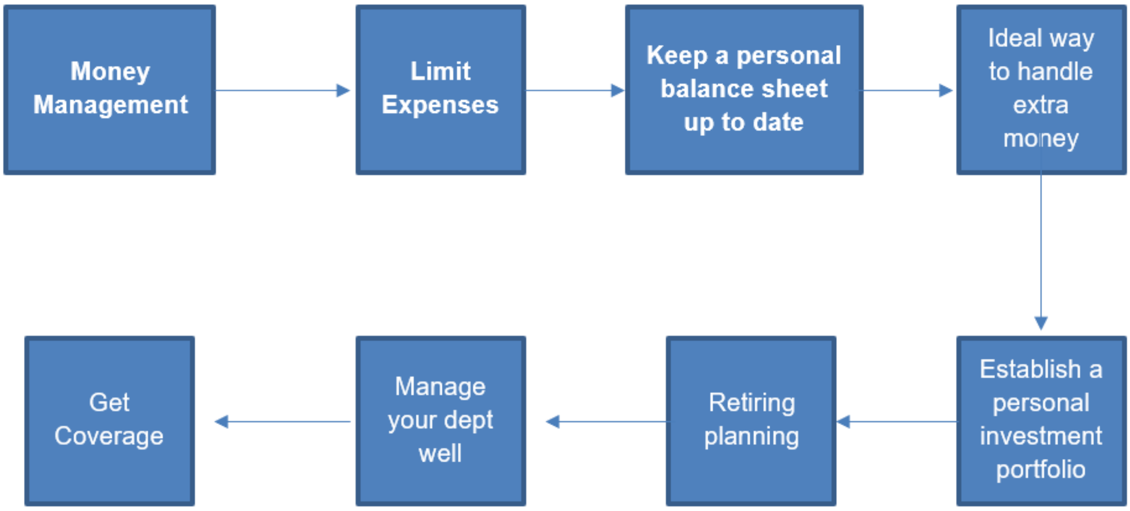
Required:

1. Build a cash flow projection for the next 3 years for your chocolate business.
2. Is the chocolate shop worth your time as an investment according to your criteria?

Solution:

Year	1	2	3
Chocolate sold	10,000	15,000	25,000
Cash inflows			
Sales (cones * $4)	40,000	60,000	100,000
Cash outflows			
Materials (cones * $1)	10,000	15,000	25,000
Rent	20,000	20,000	20,000
Equipment lease	10,000	10,000	10,000
Staff	10,000	10,000	20,000
Overhead	10,000	5,000	5,000
Total outflows	60,000	60,000	80,000
Net cash flow	(20,000)	0	20,000

3.4.3 Individual Financial Planning



Activity-2

Amit and Lata, a couple on a salary, reside in East Delhi. Lata holds a job as a teacher, whereas Amit holds a position as Manager at a private bank. There are four people in the family, including two children. Their total monthly income of Rs. 1,000,000 implies they make Rs. 12,000,000 annually. Their monthly expenses are Rs. 40,000, and their yearly expenses are Rs. 4,80,000 (Household expenses plus insurance plus childcare costs). Plan investments (PPF + property + bank savings + stocks + jewelry) for the future.

In Text Questions

4. Financial Planning is the process of estimating ——---.
5. Financial Planning ensures balance between cash ——--- and ——---- to ensure stability.

3.5 DIFFERENT TYPES OF BUDGETS

A budget is a plan for how much money will be spent over a certain period of time.

3.5.1 Personal Budget

Personal budget or household budget is a strategy for balancing a person's or household's resources (income and expenses).

Why You Should Make a Personal Budget:

Personal budgets are frequently made to assist a person or family in managing their expenditures and achieving their financial objectives. A budget can make it simpler for people to manage their finances, giving them more control over their ability to save money and avoid overspending. Budgeters are less likely to accumulate huge debts, are more likely to retire well, and are more likely to be ready for crises.

(a) Personal Finance Techniques:

The simplest method of making a personal budget requires the person to figure out their net income, monitor their spending over time, set goals based on the data acquired, develop a strategy to reach those goals, and alter their spending accordingly. To aid people in doing this, there are numerous budgeting techniques.

(b) 50/30/20 Budget

The 50/30/20 budget is a straightforward strategy that separates personal expenditures into three categories: "Needs" (essential needs), "Wants," and Savings. After that, 50% of net income is allocated to meet essential requirements, 30% to satisfy wants, and 20% to save.

(c) 80/20 method (pay your first):

People who follow the pay your first budget save at least 20% of their net income first, then they can spend the remaining funds as they like. They can even adopt a 70/30, 60/40, or 50/50 budget to save even more. The most crucial aspect of this strategy is saving money before making any other purchases.

(d) How partial savings accounts are used:

This strategy is an adaptation of the "pay yourself first" budget where numerous savings accounts are set up, each for a particular objective (such a trip or a new automobile) and each with an amount to be attained by a particular date. The amount to save each month is then determined by dividing the required sum of money by the planned expenditures.

(e) Cash-only budgeting using the envelope method:

Cash is used in this way as opposed to debit or credit cards. People are required to separate their net income into different categories (such as groceries), withdraw the money designated for each category, and place it in envelopes. They only take the designated envelope each time they want to make a purchase in one of the categories in order to avoid going over budget.

(d) **Zero-based budgeting:**

In a zero-based budget, all net income must be used up before any expenses.

Activity-3

You might have a part-time job or an internship while in college to help pay for your education and cover living expenses. This sum of money is a crucial component of your budget. List the monthly costs. Organize your spending into categories that are both fixed (books, bills) and variable (travel, entertainment). Find out what each expense costs on a monthly average. Comparing net income after taxes to monthly expenses, make adjustments as necessary by increasing income or decreasing expenses.

3.5.2 Family Budget

A budget is a plan for all of our financial transactions, including both inflows and outflows of funds (expenses). This strategy is developed for the entire household using a family budget. And the best family budgets include everyone in the family (at least to some degree). The advantages of managing a home as a family are numerous. Here are our top three: 1) We will start directing our money instead of wondering where it went. 2) We can begin to get everyone on the same financial page. When we have open conversations about money, we demonstrate that it is not a taboo topic.

Three steps to creating a family budget

Budget Step 1: List your income.

Write down each regular paycheck, and don't forget to include any additional funds we may receive from side jobs, garage sales, freelance work, or other sources. Enter the lowest estimate of our normal income if we have irregular income. (We can change this later in the month if we earn more.)

Budget Step 2: **List expenses.**

We can now plan our expenses since we have our income planned. Time to make a list of our expenses! (Pro tip: to estimate expenses, open an online bank account or consult your bank statements.) We can start by taking care of the "four walls," which are housing, food, and utilities. Some of these costs are referred to as fixed costs because they are consistent month to month (like our mortgage or rent). Others, like groceries, change. The budget line for groceries is pretty hard to guess at first, but we can learn what we will actually need in the coming month. All other monthly expenses should be listed like insurance, debt, savings, entertainment, and all personal expenses. Start with the fixed expenses. Then, online bank accounts or statements can be used to estimate projected amounts for everything else based on spending over the past few months.

Budget Step 3: Subtract income from expenses.

When we subtract our income from our expenses, the amount will be zero. This does not mean that our bank account is at zero: it means that every part of our income has a purpose. (This is called a zero-based budget)

3.5.3 Business Budget

- A business budget aids the owner in determining whether there is sufficient capital to support operations, grow, and bring in revenue.
- A company without a budget risks the danger of overspending, underspending to maintain competition, or under saving for emergencies.
- A spreadsheet predicting the sum of money required to be spent on expenditures can be made by reviewing industry standards to ascertain the typical cost of doing business.
- The budget should have some leeway to accommodate unforeseen expenses, and it should be looked at to see where costs may be reduced in trying times
- Every few months, the budget should be reviewed, and new suppliers should be investigated in order to reduce costs for any necessary goods or services.

A great small business budget can be created using these six straightforward suggestions:

(a) **Verify industry norms**

Although no two businesses are exactly alike, they all have a few characteristics. Therefore, homework must be completed. To find out more about the industry, we can conduct an Internet search, speak with local business owners, visit the library, and visit the IRS website. This will give us an indication of what proportion of income is likely to be allocated to cost groups.

Small businesses can be extremely volatile, as they are more susceptible to industry downturns than larger businesses due to more diversified competitors. So rather than looking for specifics, we should only search for an average here.

(b) **Make a spreadsheet**

Make a spreadsheet to project the entire amount and percentage of revenue that will be required to cover raw materials and other costs before purchasing or launching a business. Before beginning, it's a good idea to get in touch with every vendor we'll be working with. The same is true of rent, taxes, insurance, and other expenses. It's crucial to understand the different budgets we will need to create for our small business and how to implement them.

(c) **Allow for some flexibility**

Even if we think that the business will see a specific amount of sales growth in the future or that certain expenses are fixed or can be controlled, these are just estimations. So, before we expand the company or add more staff, it's a good idea to budget for some wiggle space and ensure that we have more money coming in than we need.

(d). **Cut expenses**

Consider cost-cutting measures when you need to find money quickly to cover a significant expense, advertise, or seize an opportunity. Particular attention should be paid to things that are mainly under our control. Another option is to postpone purchases until the beginning of a new billing cycle or to make the most of the payment terms provided by creditors and suppliers. The business owner can allow themselves the breathing room they need to grow by exercising a little caution in this area.

(e) **Consistently evaluate the company**

Small business owners should create budgets more frequently, even though many organizations only do so once a year. In fact, because business can be unpredictable and unforeseen expenses might alter revenue projections, many small business owners only make plans a month or two in advance. To make sure they have enough money to satisfy their business objectives, entrepreneurs can use an excellent tool called a budget planning calendar.

(f) **Shop for services/suppliers**

We shouldn't be reluctant to search for new vendors or make cost-savings on other services offered to our company. When purchasing or launching a firm, creating annual or monthly budgets, and doing routine business reviews are all instances where this may and should be done.

Example of a business budget

Here is a complete example of a bakery's business budget: Master budget for the second quarter: Total balance of last quarter/Opening cash balance: Rs.10,000, Direct materials cost: -Rs.4998.50, Labor cost: -Rs.20,000, Overhead cost: -Rs.1,000, Total operating cost: -Rs.25,998.50, Sales or cash receipts: Rs.50,000, Financial: -Rs.5,000, **I**nvestment: -Rs.20,000, Total Cash Payments: -Rs.51,000, Budgeted Ending Cash Balance: Rs.9,000, Purchase of industrial mixer: -Rs.900, Maintenance of industrial oven: -Rs.2,000, Total capital expenditures: -Rs.2,900,Total balance/opening cash balance of next quarter: Rs.6,100

3.5.4 The National budget

The process of forecasting income and expenses for a specific time period is called budgeting. A country's budget is its national budget. The government uses the money it collects through taxes and fees to fund social programs like Social Security and Medicare, as well as infrastructure projects, grants for research, education, and the arts, and national defense.

The government's annual financial report, or budget, lays out the country's fiscal course for the following year. The Niti Aayog and other relevant ministries are consulted throughout its preparation by the ministry of finance. The nodal entity in charge of preparing the Budget is the Department of Economic Affairs (DEA) in the finance ministry. The budget-making process begins in August or September, or about six months before the presentation date. Before the start of the fiscal year, which is April 1, it must be approved by both houses of Parliament.

(a) **Circulars are sent to all ministries**

The finance ministry has sent out a circular to all ministries, states, Union territories, and autonomous bodies requesting that they create estimates for the upcoming fiscal year. The circular includes the necessary recommendations as well as skeletal forms, depending on which ministries make their expectations. The ministries describe their earnings and expenses from the previous year in addition to offering their estimates.

(b) **Received consultations on plans**

It is then examined by senior government officials after requests are received. The departments of expenditure and the ministries hold extensive consultations. The information is then sent to the finance ministry after approval.

(c) **Distribution of income**

Following review of all submissions, the finance ministry allocates funds to various departments for upcoming expenditures. The finance ministry consults the Union Cabinet electronically. Budgeting is the process of estimating revenues and expenditures during a given period or the Prime Minister if there is a disagreement over the distribution of funds. The DEA and department of revenue also communicate with other stakeholders, such as farmers, small business owners, and foreign institutional investors, to gather more information

(d) **Pre-Budget conferences**

The finance minister has pre-budget discussions with significant stakeholders to learn about their requests and ideas. State representatives, bankers, agriculturalists, economists, and labor unions are a few of these stakeholders. The finance minister makes the final decision on all matters after the pre-budget consultations are complete. Prior to finalization, it is also discussed with the Prime Minister.

(e) **Printing of the budget and document completion**

The government maintains an annual tradition of holding a halwa ceremony a few days before the presentation of the Budget. The ceremony heralds the start of Budget materials printing. A a giant "kadhai" (large frying pot) is used to produce "halwa," which is then fed to the entire personnel of the finance ministry as part of the ritual. The event is significant because after the sweet dish is served, many officials and support staff who are directly involved in the budget-making process are required to stay in the ministry and remain separated from their families until the budget is presented. However, printing of documents has been abolished since 2021 and the budget is submitted in electronic form.

(f) **Presentation of the budget**

Finance minister presents the budget in Lok Sabha. Until 2016, it was delivered on the last day of February. However, from 2017, the budget has been announced on February 1 every year.

In Text Questions

6. A Personal Budget is a plan for coordinating the —-- and ——-- of a person.
7. Zero based budgeting requires income to be ——-- before ——-.

3.6 PLANNING AND BUDGETING PROCESS

Planning and budgeting are an analytical tool that aids in the creation of a bottom-up budget that serves as the framework for our organization's operations as well as top-down goals. It enables the organization to work cooperatively and effectively through the iterative budgeting process, which involves reevaluating expenditure and revenue estimates, changing initial and final dates, and changing targets. It assists management in evaluating business alternatives and setting financial goals.

Different departments are able to use suitable tools based on the same assumptions thanks to planning and budgeting. Any member can interact with their portion of the company plan or budget at any time, from any location in the globe, by making a shared business model with role-based access available over the Internet. We are able to react swiftly and effectively to a dynamic business environment. We can simulate changes in staffing numbers, cost control methods, and capital spending plans before they are put into practice using "what-if" analysis and modeling. Instead of only once a year, proactive real-time responses can be made to marketing variations and other departures from the original plan.

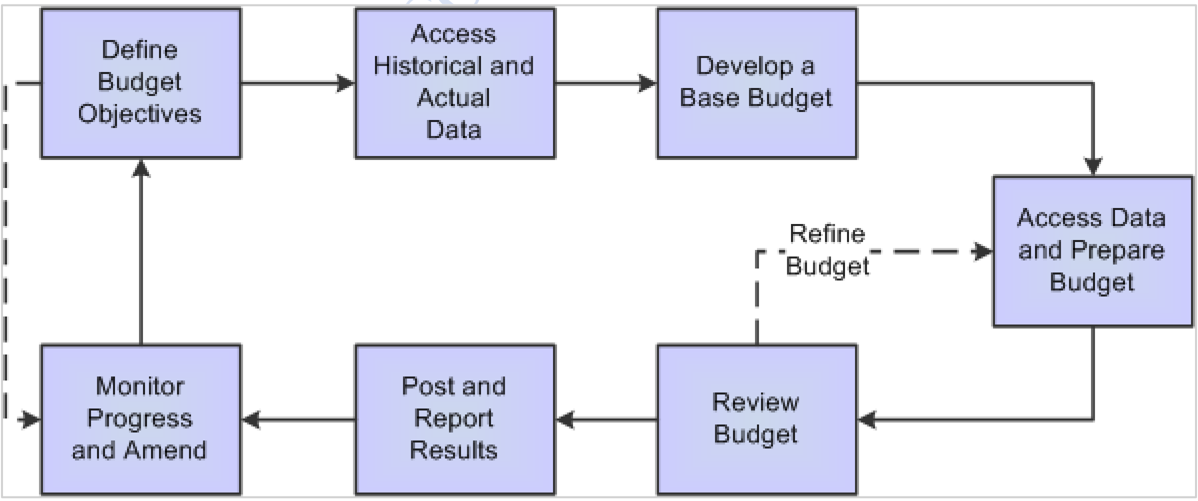
Budgeting and planning are useful for:

- Set planning objectives.
- Access and examine recent and historical data.
- Connect daily procedures to strategic objectives.
- Connect bottom-up budgets to top-down goals.
- As the state of your business changes, integrate and update your financial reporting.
- Carry out ongoing forecasting.
- Multidimensional modeling of planning and budgeting data in real time.

Planning & Budgeting saves data in relational database tables, just like other People Soft programmes. This data can be extracted, viewed, scrutinised, and changed before being reinserted into the original tables. Our ability to play our part in the planning and budgeting process at our business depends on our ability to comprehend the underlying principles of this process as well as the tools that allow us to change the data.

Image: **Planning and Budgeting process**

This flowchart illustrates the Planning and Budgeting process, which includes defining budget objectives; accessing historical and actual data; developing a base budget; preparing, reviewing and refining a budget; posting and reporting results; and monitoring progress and amending the budget.



3.7 BUDGET DEFICIT AND BUDGET SURPLUS

An overrun in spending over income results in a budget deficit, which can be a sign of a nation's financial stability. The phrase is frequently used to describe government spending rather than that of companies or people. Budget deficits have an impact on the total amount a nation owes to creditors, the total of its annual budget deficits, and the national debt. A budget deficit results in an accounting loss, which shows that no gain was reported and that instead, expenses exceed income. To cut the budget deficit, people, businesses, and the government all take different actions. The most typical solutions to this problem involve spending reductions and income increases. A budget's deficit can be minimized by cutting expenses and taking part in initiatives designed to increase revenue. Additionally, some actions, such as significant borrowing, might worsen a budget imbalance. The 20th century saw the biggest budget deficits ever recorded since most nations at that time were spending more than they were earning. A budget deficit may result in increased borrowing, greater interest costs, and insufficient reinvestment, all of which reduce revenue for the next year. A budget surplus is the polar opposite of a budget deficit. When there is a surplus, revenue outpaces existing costs, leaving extra money that can be used for other purposes. The budget is deemed balanced when inflows and outflows are equal.

The following are key details to understand about a budget deficit:

- When expenses (expenditures) exceed income, there is a budget deficit (revenue). The opposite of a budget deficit is a budget surplus, which happens when income exceeds expenses.
- A budget deficit can occur in individuals, businesses, or governments.
- Tax system that overtakes low-wage earners while undertaking high-wage earners.
- A rise in the amount spent on programs like Social Security, Medicare, or the military.
- Government subsidies to some businesses are increased.
- Tax reductions that result in a drop in income yet give businesses money to hire more people.
- Tax income declines when the gross domestic product (GDP) is low.

When it happens, a budget deficit can be very dangerous for a nation, a business, or an individual. The inflation that will eventually lead to a recession is one of the main risks of the budget deficit. Because a persistent budget deficit is bad for the economy, governments have developed a number of methods to reduce them.

3.7.1 Effects of a Budget Deficit

Individuals, businesses, and the general economy are all impacted by budget deficits. The government may reduce spending on programs like Medicare or Social Security as it works to reduce the deficit. Infrastructure upgrades can potentially be impacted. Tax increases for high incomes or big businesses may be implemented to boost revenue, which may limit their capacity to make investments in new initiatives or recruit new staff. Inflation, or the persistent rise in prices, is a looming issue with a budget imbalance. In the US, a budget deficit may prompt the Federal Reserve to inject more money into the economy, feeding inflation. Year after year, budget deficits may also result in inflationary monetary policies.

Explained with the help of example: Sheela is the founder of a small start-up business that makes artistic handcrafts. In order to widen her own business, she decided to purchase a factory and other necessities. Furthermore, she was also required to hire and also pay the employees, and also take care of their benefits. In the first year, Sheela's company had a budget surplus of Rs. 50,000. But, in the next year, the economy went through a period of recession thus her business that year lacked growth and she could only sell her handicrafts worth Rs. 200,000. Her cost, on the other hand, escalated to Rs. 500,000. Now, her company ran into a budget deficit of Rs. 250,000 (Rs. 500,000 – Rs. 250,000)

3.7.2 Three types of Budget Deficits

3.7.2.1 Fiscal Deficit

Meaning:

The fiscal deficit offers a more thorough understanding of the budgetary imbalances. It is frequently used as a tool for budget analysis to explain and comprehend budgetary developments

in India. The term "fiscal deficit" describes the difference between total expenditures and total receipts (exclusive of borrowings) for a given fiscal year.

Consequences of the fiscal deficit

1. Debt Trap: Fiscal deficit reveals the entire amount of borrowing that the government is required to do. In addition to the principal repayment, borrowings also call for interest payments. Interest payments raise revenue expenditures, creating a revenue shortfall. It produces a fiscal imbalance and revenue deficit that spirals out of control, forcing the

government to take on more debt in order to pay off earlier debt. The outcome is that the nation is mired in debt.

2. Inflation: To cover its fiscal deficit, the government primarily borrows from the Reserve Bank of India (RBI). To satisfy the deficit requirements, the RBI creates additional money. It expands the availability of money in the economy and feeds inflation.

3. Foreign Dependence: The government also takes out loans from other nations, increasing its reliance on foreign nations.

4. Hampers the future growth: Future growth is hampered by borrowing, which raises the cost for subsequent generations. It has a negative impact on the country's prospects for future growth and development.

Sources of Financing Fiscal Deficit:

The government must consider a variety of options to cover the fiscal deficit. Two primary sources are:

1. Borrowings: To cover the fiscal deficit, either internal (from the public, commercial banks, etc.) or external sources may be used (foreign governments, international organizations etc.).

2. Deficit Financing (Printing New Money): The government may borrow money from the RBI using its securities as collateral. The RBI creates new money for this use. Deficit financing is the name given to this process. Since borrowings don't expand the money supply, which is thought to be the primary driver of inflation, they are preferred to other sources of funding. On the other hand, because there is more money available, deficit financing may cause inflationary trends in the economy.

3.7.2.2 Revenue Deficit

Meaning:

It demonstrates the disparity between revenue expenditure and revenue receipts. It shows that the government is unable to cover its ongoing, recurring expenses.

Consequences of a Revenue Deficit

- It shows that the proposed budget does not include the government's regular and recurring expenses.
- It suggests that the government is consuming the savings of other economic sectors to pay for its expenses.

- This implies that the government must offset this imbalance through capital inflows, disinvestments, and borrowing. This causes the liabilities to rise and the assets to decline.
- Inflation in the economy results from using capital receipts to pay for expenses. Future load is increased by high borrowing.
- A significant revenue deficit is a red flag that the government is unable to reduce spending or boost revenue.
- In order to fund development initiatives, revenue receipts should always exceed revenue expenditures. But for the previous few years, the Indian Budget has had a revenue deficit.

Suitable Measures

- The government may choose to raise its tax and non-tax earnings or elect to reduce key expenses in order to close the revenue gap.
- The corrective actions taken in response to such a government deficit.
- By identifying wasteful and ineffective spending, the government should cut costs.
- Income tax rates could rise, which would aid in reducing the deficit.
- New taxes being imposed in areas such as imports, customs, highways, food, etc.
- To cover the deficit, the government may choose to sell some of its holdings.

3.7.2.3 Primary Deficit

Meaning:

It can be defined as the fiscal deficit of a specific year, exclusive of interest payments on prior borrowings. Simply put, the budget deficit tends to show how much money the government needs to borrow, including the cost of loan interest. The main Deficit, on the other hand, shows the amount of borrowing necessary but without including loan interest payments. The government uses the primary deficit to determine how much borrowing is necessary to cover all costs, except loan interest payments. In particular, when this kind of government deficit is zero, it means that all the government needs to do is borrow enough money to cover the interest payment.

It can be expressed as Primary Deficit = Fiscal Deficit – Loan Interest Payments

Consequences of Primary Deficit

- It shows what portion of the government's borrowings will be used for expenses other than interest payments.
- The gap between primary and fiscal deficits shows how much of the borrowings' interest payments have already been made. A primary deficit that is low or non-existent suggests that the government has had to borrow to cover interest payments on prior loans.

3.7.3 Sources for meeting the Deficit (Deficit Financing)

- When the government's overall income (revenue account plus capital account) is less than its total expenditures, deficit financing may result.
- The government may choose to borrow money from the public by issuing bonds and other securities, ordering the RBI to create fresh currency notes, or withdrawing funds from its cash balance deposited with the RBI.
- Ad-hoc Treasury Bills are used to obtain loans from the central bank, private banks, and even state governments to cover the deficit.

Need for Deficit financing

- When there are not enough resources to conduct out economic activity. Deficit financing is used to achieve fiscal deficit goals.
- It is preferred as the price rise is considered to be a lesser evil and is therefore preferred over a lower growth rate.
- It also happens as expenditures expand quickly.
- Deficit finance may also result from higher spending on useless and non-developmental activities.

Types of Deficit financing

The following methods can be used to finance government debt:

- **Borrowing from Public and Foreign Governments**: Instead of withdrawing cash balance maintained with the RBI or borrowing from it, governments typically borrow from their constituents or from foreign governments. The market's availability of money is unaffected by governmental borrowing because when the government borrows, ownership of the people's money changes.

- **Cash withdrawals from Reserve Bank of India (RBI) accounts:** Using the Reserve Bank of India as a lender, any money that flows out of RBI tends to increase the amount of money available in the economy, which raises prices in the domestic market.

Impact of Deficit Financing

- It raises aggregate expenditure, which raises aggregate demand and raises the risk of inflation.
- Inflation might also result from deficit financing.
- Additionally, it triggers the process of economic surplus, which promotes economic growth.
- It helps emerging nations satisfy their liquidity needs.
- Additionally, it raises the possibility of significant economic upheaval.

Advantages of Debt Financing

- Taxpayers are not bothered by deficit financing because the government borrows their surplus funds.
- Here, the government borrows money from the RBI to generate more money, and the interest payments linked with the borrowing are given back to the government.
- It strengthens the government's financial position.
- It causes inflation, which in some situations may be advantageous.
- Given that it encourages the government to use resources that are underutilised and unemployed, it may have a multiplier effect on economic growth.

Disadvantages of Deficit Financing

- It leads to price increases and inflation, which can become a vicious cycle.
- The lack of benefits for people with stable income sources might result in income inequality.
- The entire investment system is disrupted because most capital is drawn to sectors with high short-term profit margins but low long-term growth potential.
- Less job chances are created in poorer countries since they lack other resources like infrastructure, machinery, etc.
- Money may lose some of its purchasing power, which could result in a capital flight from the nation.

For nations with sluggish rates of economic growth, this kind of financing is crucial. However, if sufficient anti-inflation measures are also implemented, deficit financing can be successful. Since it is an inescapable source of funding, sti-inflation measures are implemented alongside other required measures.

3.8 AVENUES FOR SAVINGS FROM SURPLUS

Everyone wants to learn how to save money but finding the most effective strategies can be challenging. It is simple to believe that all we require is a small monthly deposit into an account designated for savings.

Followings are the different options for savings:

1. **Recurring Deposit (RD):**

Recurring deposits are one of the most popular payment methods. Here, a fixed sum can be deposited on a regular basis, let's say monthly, and deposits can earn a fixed rate of interest.

A bank RD is a sort of term deposit where the investor makes consistent, fixed monthly investments and obtains a rate of return comparable to that of a bank FD for a predetermined amount of time. There is no tax deductible at source, but interest received on RDs is taxed on an accrual basis according to one's income tax bracket. Since the interest rate is fixed over the term, it is secure. Additionally, it allows for deposits of as little as Rs. 500.

2. For people over 60, the **Senior Citizens Savings Scheme** provides a steady income, the highest level of safety, and tax savings.

3. **Fixed Deposits in a Bank (FD):**

Our monthly savings can also be safely parked in bank fixed deposits. It requires little to no documentation, making it the easiest. We have the option to put some of our savings into bank FDs in addition to the Senior Citizens Savings Scheme (SCSS). The main benefit of FD is liquidity. Despite the fact that they might be lower than average. Bank FDs are term deposits in which the investor invests a lump sum and receives a higher rate of return than a savings account for a predetermined amount of time. Tax at source (TDS) would be withheld by the bank at a rate of 10% p.a. if the interest amount is greater than Rs 10,000.

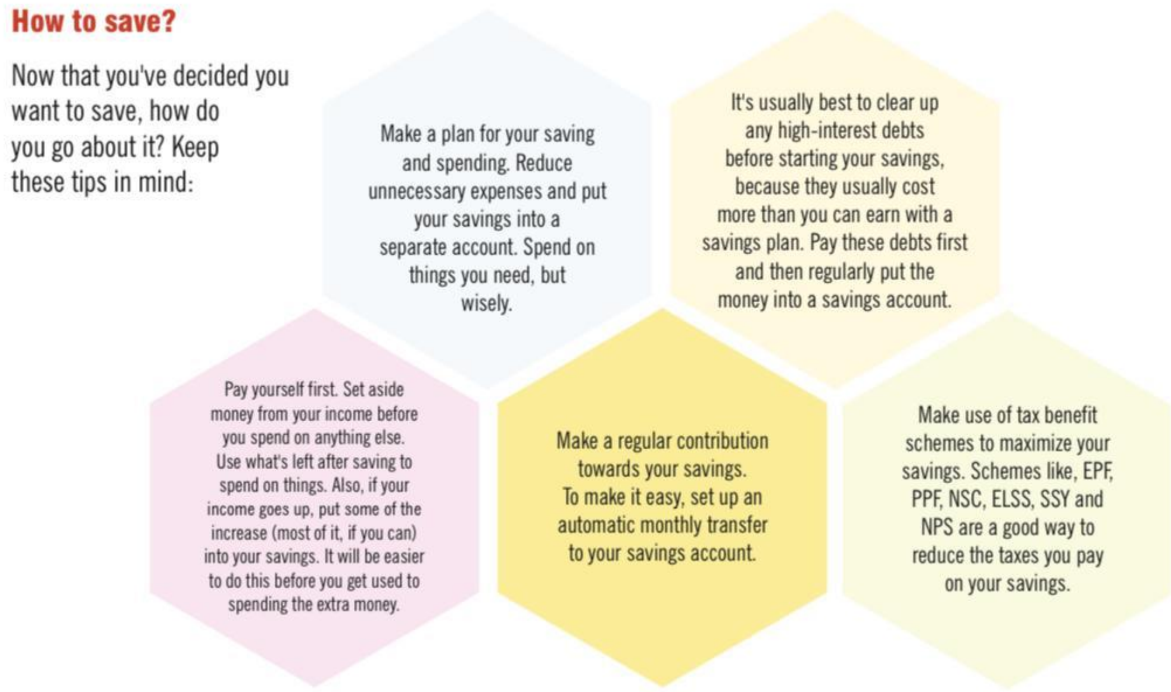
4. One of the earliest small savings tools provided by the Post Office of India is the **Kisan Vikas Patra**. KVP was reintroduced in 2014 with some changes. A KVP plan can be invested in jointly, personally, or in the name of a minor. In just 8.7 years, the principal invested in KVP could double.

5. **Ultra-short-term and liquid funds:**

Open-ended mutual funds known as "liquid funds" invest largely in debt securities with maturities of up to 91 days, such as Treasury bills, Commercial Papers, Term Deposits, and Certificates of Deposits (CDs). They have a very minimal danger and are quite liquid. Additionally, withdrawals can be executed within 24 hours on a business day, and they don't carry any exit loads. In light of this, liquid funds are appropriate for managing short-term liquidity needs, such as those associated with investment horizons shorter than three months.

6. **Savings Account:**

This is a tried-and-true method for storing short-term needs, as well as for setting aside cash to handle emergencies. Earnings range from 4% to 6% annually. depends on the bank selected to hold deposits. But too much surplus cannot be kept in a savings account if one wants to manage short-term liquidity and combat inflation, which reduces the purchasing power of our hard-earned money. It will turn out to be foolish. You can build a contingency or emergency fund by setting aside 6–12 months' worth of expenses.



Activity-4

X retired last year. He receives a pension of Rs. 40,000 each month. He received 20 Lakhs in gratuity and P.F. from his employer. What is the best place for him to keep his extra cash?

In Text Questions

8. A Budget Deficit occurs when expenses ——-- revenue.
9. Saving accounts is the oldest method to keep ——--.
10. Safest avenue for savings for senior citizens called——--.

3.9 SUMMARY

The social science of economics examines the processes of production, distribution, and consumption. It involves making choices on the distribution of finite resources in order to maximize their usage and satiate human desires and requirements. The act of measuring the necessary capital and figuring out its competition is known as financial planning. It is the process of establishing a company's financial strategy with regard to raising, investing, and managing capital. A budget is a plan for how much money will be spent over a specific time period; the amount that is indicated. When spending outpace income, a budget deficit is created, and this can be a sign of a nation's financial stability. There are several ways we can invest our surplus savings. Plan your spending and saving. Cut back on wasteful spending and save money in a different account. Spend money sensibly, but on items you need. Prior to beginning your savings, it is always better to pay off any high-interest debts because they will typically cost you more than you can make through a savings plan. After paying all these obligations, routinely deposit the remaining funds into a savings account. First, pay yourself. Before you spend money on anything else, set aside money from your income. Spend any remaining funds after saving. Additionally, if your income increases, consider investing some of it—preferably the majority—into your savings. Before you get used to spending the extra money, it will be simpler to accomplish this. Contribute on a regular basis to your savings. Create an automatic monthly transfer to your savings account to make it simple. Utilize tax benefit programmes to increase your savings. Using programmes like EPF, PPF, NSC, ELSS, SSY, and NPS, you can lower the taxes you have to pay on your savings. To ensure that your future is financially secure, saving is a crucial step. Start early to give your savings the most growth potential.

3.10 GLOSSARY

Needs - Basic requirements of any individual

Wants -refers to choose, unlimited

Scarcity of resources- means to satisfy wants

Planning - process of setting up goals for a given period of time

Budget - A Budget is a plan of how to spend an amount of money over a particular period of time.

Deficit - when expenses exceed revenue

Deficit Financing - When the government's overall income (revenue account plus capital account) is less than its total expenditures, the difference being made up by borrowing or minting new funds.

Avenues for savings - options for savings

3.11 ANSWERS TO IN TEXT QUESTIONS

1. Needs	6. Resources and expenditure
2. Limited	7. Spent, expenses
3. Unlimited	8. exceeds
4. required capital and determining its competition	9. Small amount safe
5. cash outflows and inflows	10. The Senior Citizens Savings Scheme

3.12 SELF-ASSESSMENT QUESTIONS (SHORT ANSWER QUESTIONS)

Q1. Define the meaning of wants and needs.

Q2. What do you mean by scarcity of resources?

Q3. What is financial planning?

Q4. Define different types of budgets in brief.

Q5. What is the Budget Deficit?

Q6. Outline avenues for savings from surplus.

Q7. What is Deficit Financing?

Long answer questions

Q1. Write down the objectives and importance of Financial Planning?

Q2. Explain in detail the different types of budgets and the methods of making these budgets.

Q3. Explain in detail Budgeting Planning and its Process.

Q4. What are the three types of Budget Deficits? Explain their implications and suitable measures to correct them.

Q5. Give in detail the different types of Avenues for Savings from Surplus.

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Unit-II

LESSON-1

INTRODUCTION TO BANKING AND INSURANCE

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STRUCTURE

1.1 LEARNING OBJECTIVES

After reading this Unit you should be able to:

- Recall the different types of banks
- Understand and distinguish the different types of services by banks
- Get knowledge on the different types of bank deposit accounts
- Explain the various types of loans

1.2 INTRODUCTION

In Unit I you have been made aware of the meaning and importance of financial literacy and its perquisites. You have also gained knowledge of the various financial institutions. You have also been made aware of the concept of Economic wants and how to satisfy them. Another important topic that you would have gained knowledge on would be the meaning, importance and need for financial planning along with learning about the budget and its different types and the various terms associated worth it. You would also have understood the different ways of savings and how the deficit is met.

In this unit you will be given detailed classification about the types of banks and the kinds of service that banks offer to their customers. After going through this Unit, you will also be able to identify the different types of bank deposits and gain knowledge about the different types of loans.

1.3 TYPES OF BANKS

In the previous unit you have been made aware of the term bank and its different functions. There are different types of banks, some of which are discussed below:

- Reserve Bank of India (RBI)-It is the Central bank of the country and is also called as the Banker's bank. Its functioning is regulatory in nature as it regulates the functioning of all other banks operating in India. hence supervises the functioning of the entire banking sector in India. It has a key role to perform information of monetary policies and foreign exchange mechanism. Some of the key issues it has assay in are related to customer care, disclosure of financial position etc. There are no dealings with the general public unlike all the other banks. Only RBI is entrusted with issuing currency.
- Commercial Banks: In other sense these are companies established under special Acts. These can be domestic or foreign in nature.

Primarily commercial banks can be divided into two categories: Scheduled Banks and Non-Scheduled Banks

What are Scheduled Banks?

Banks mentioned in the list in the 2nd Schedule of the Reserve Bank of India Act 1934 are scheduled banks. These are further categorised into Private, Foreign and Multinational banks. Cooperative banks too fall in this category if they fulfil certain criteria.

Non-Scheduled Banks

Those that are not listed in the above are obviously non-scheduled banks. There are a total of 1458 non- scheduled banks in India as per the latest information available at the time of preparing this lesson.

- Regional Rural Banks (RRBs)- These are established by the Govt- be it national, state or at the union territory level. There operations are limited and local to the state or UT in which they are established. Hence their area of operation is predefined
- Public Sector Banks- AS the name suggests, more than 50% of the shares are in the hands of the public namely the govt (central or state). State Bank and its associate banks as well as other nationalised banks are PSBs
- Private Sector Banks- In addition to 3 and 4above are private sector banks, owned and managed privately. Unlike public sector banks, their priority is not the economic welfare but their own profitability and the objective of formation of such banks. Nevertheless, they too have to follow the RBI rules and regulations in force. Some of them are ICICI, HDFC etc

- Cooperative Banks- The word cooperative means autonomous association of people aspiring to meet their own economic, social and/or cultural objectives through an entity jointly controlled and owned. The binding factor is mutual trust. These banks operate on the same lines as other banks but on no profit no loss basis. These are registered under Cooperative Societies Act 1912 and these too are RBI regulated. These can be rural or urban in nature. As these are often backed by different states in India the word cooperative is often fixed before the word cooperative. Rajasthan State Cooperative Bank and Maharashtra State Cooperative bank are some examples
- Foreign Banks- As the name suggests, these banks re incorporated in foreign land. The big difference is that they have to abide by the rules and laws of their home country as well as those in force in India (RBI). In a nutshell. They are neither govt owned nor registered in India e.eg, HSBC, Barclay's Standard Chartered etc
- Development Banks- Immediately after independence the need was felt to promote the lagging sectors of the economy and hence Development Banks came into being. There are 4 types- Industrial, Agricultural, Export Import and Housing. Thus, they are known as Specialised Financial Institutions.
- Export-Import Bank: These banks came into existence for the sole purpose of providingfinance specifically for promotion of foreign trade. Export-Import Bank of India was established as an apex bank to finance entities in the field of export and import through commercial banks.
- Housing Bank: Theseprovide finance for the housing sector and related activities associated with the housing sector like construction of houses, plots, house repairs, etc. National Housing Bank was established to provide housing finance through commercial banks and other agency

IN-TEXT QUESTIONS

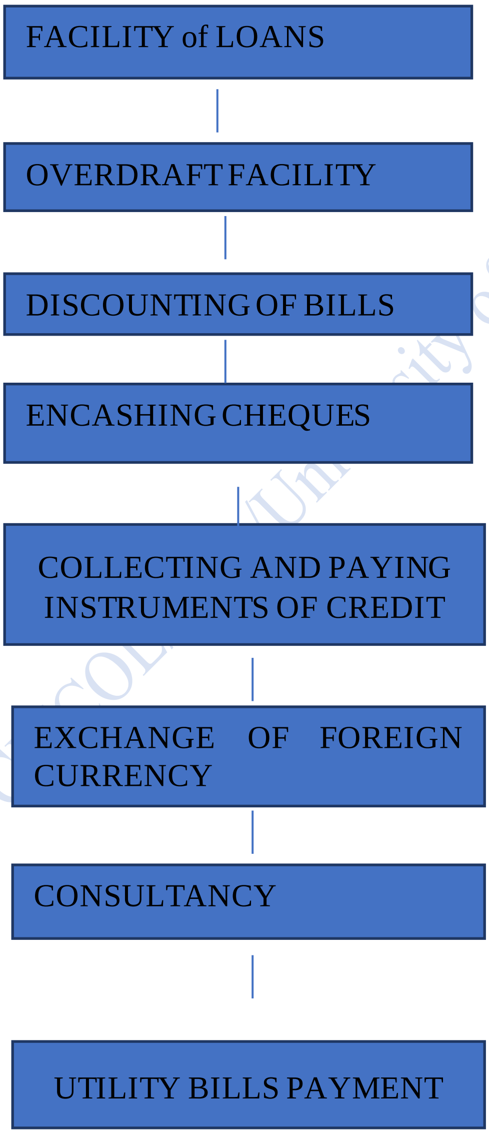
1. ……… is authorized to print currency notes by government of Indi
2. ……… Banks are companies established by Special Acts

1.4 VARIOUS SERVICES OFFERED BY BANKS

The main task of the scheduled banks is attracting deposits from investors and utilising it to run their organisations.

Let us see an example:

A person deposits some money with a bank and gets interest on it. Another takes a loan from the bank and pays interest on it. The difference of the interest becomes the primary income for that bank. So primarily the bank is the custodian of other people's money.



Over the last few years, the banks have redeveloped themselves and are offering a wide range of services, some of which are mentioned below:

FACILITY of LOANS

Other than accepting deposits for different time durations, banks deal in advancing loans to different types of entities ranging from individuals to large multinational companies. The interest that they earn from giving these loans in their main source of income. They fulfil the requirement of funds of the different sections of the society.

OVERDRAFT FACILITY

Some of the customers are given the facility to withdraw more than the money in their account. The bank earns interest on the amount withdrawn.

DISCOUNTING OF BILLS

The holder of this instrument can get the same discounted at the bank for improved cash flow in the business esp. at the time when funds are needed urgently. For this service the bank gets a commission.

ENCASHING CHEQUES

Banks extend this service to both savings and current account holders. Cheques can today be encashed across any bank branch esp. in case where the bank offers Core Banking Solution or CBS which is usually written on the face of the cheque. Some banks offer the facility of multi city cheque books to their account holders

COLLECTING AND PAYING INSTRUMENTS OF CREDIT

Services like collecting Credit instruments such as promissory notes and bills, As mentioned earlier the bank provides this facility as a custodian on behalf of its customers.

EXCHANGE OF FOREIGN CURRENCY

Another service offered by banks is to convert local foreign currency to local currency needed for account holders dealing in trade outside India.

CONSULTANCY

It started off as a service provided to High-Net-worth Individuals or HNIs and today most banks offer financial consultancy service to those customers who are interested in enhancing their wealth by investment in different instruments, stock market, bank assurance and even tax management

UTILITY BILLS PAYMENT

The bank may facilitate payment of bills and even taxes such as telecom bills, water and electricity bills.

ACTIVITY

How many public sector banks, private sector banks, foreign banks, regional rural banks, urban cooperative banks andrural cooperative banks are there in India?

IN-TEXT QUESTIONS

3. Service of ………. chequesare extended to both savings and current account holders
4. Two examples of credit instruments are ………………… and …………….

1.5 VARIOUS TYPES OF ACCOUNTS

There are various types of accounts that banks offer for different types of customers. Some of them are discussed below:

1.5.1 SAVINGS BANK ACCOUNT

It is the nest account for Indian individuals with limited income but striving for a better and secure future. This can be opened with a limited initial amount. A minimum balance in this account needs to be maintained. The account holder also earns a quarterly interest which varies from one bank to another and also a per the directive's issues by the RBI from time to time.

Savings account is a basic account type that lets you deposit money safely with a bank. It ensures safety and access to your money whenever you need. You can withdraw your funds, either digitally or in person, at any point in time. Even foreign individuals can open an account but in joint capacity with an Indian. KYC norms need to be fulfilled.

1.5.2 TERM DEPOSIT

A term deposit is another name for fixed deposit that includes funds deposited into an account at a bank for a fixed period. Term deposit investments usually carry short-term maturities ranging from one month to about 3 years and will have varying levels of required minimum deposits. These deposits can be made by people who wish to save funds for longer periods. Hence a higher interest rate as compared to that applicable for savings account is given by the bank because the bank is reasonable sure that the specific fixed amount cannot be withdrawn by the depositor. During this time no withdrawals are allowed. These deposits are utilised by the bank to lend to other entities

1.5.3 CURRENT ACCOUNT

This account is utilised by large entities such as business houses, companies and other commercial institutions. As there are restrictions on the number of times withdrawals can be made in a savings account, and these above entities need to make multiple withdrawals to run their organisations, therefor the need to have separate accounts, here, using a cheque book or even online, the institution or its authorised representative can make multiple withdrawals and deposits. Due to its nature, there is no interest earned due to the fluidity. The number of transactions that can be performed on current accounts is usually not limited.

Other interested parties can get information about the creditworthiness of the account holder. EFT, wire transfer, net banking and even doorstep banking services are offered by the bank to these account holders.

1.5.4RECURRING DEPOSIT

This type of account is most suitable for those who are desirous of earning a fair return on their deposit.

The depositor hands over a pre-decided amount monthly for a specified time period. They will get a lump sum amount at the end of the specified period. Interest is calculated on quarterly compounded based.

ACTIVITY

Visit a nearby bank branch of any bank and find out the range of products and services on offer

IN-TEXT QUESTIONS

Write True or False against the following

5. Documentation for operating current account is much easier as compared to savings account (T/F)
6. Term Deposit is another name for Fixed Deposit (T/F)

1.6 KEY TERMS FOR DOCUMENTATION

To make it easy for the banks and their customers specific documents are required be it for opening account, applying for loans or any other transaction with the bank for the first time, hence it is important that you familiarize yourself with these terms.

1.6.1 PAN CARD

Permanent Account Number (PAN) is a ten-digit alphanumeric number, issued on a laminated card, by the Income Tax Department, to identify taxpayers in the country. Through these different transactions are tracked and cross verified by the IT authorities. PAN was introduced to facilitate linking of various documents, taxes, assessment, tax demand, tax arrears etc. relating to any entity This has helped to curb tax evasion and to widen the number of people paying taxes.

https://incometaxindia.gov.in/booklets%20%20pamphlets/tpi_pan-book.pdf

1.6.2 ADDRESS PROOF

Prior to opening an account, the bank asks for address proof as one of the conditions to verify the identity of the customer wishing to deal with the bank and avail of its services

Any of the documents mentioned below can be furnished as valid address proof.

- Passport
- Driving License
- Voter ID Card
- Job card issued by NREGA duly signed by an officer of the State Government

- Aadhaar Card issued by UIDAI
- Utility Bill, less than two months old
- Bank account or Post Office savings account statement for 3 calendar months prior to four months along with Account Opening Cheque
- Property Tax bill or Municipal Tax receipt not more than one year old

If the documents are not updated, the following documents shall be deemed to be valid for the limited purpose of proof of address:

- Property or Municipal tax receipt.
- pension or family pension payment orders (PPOs) issued to retired employees by Government Departments or PSUs, containing the address.
- letter of allotment of accommodation from employer issued by government entities

1.6.3 KYC NORMS

Short for Know your customer it is a mechanism to verify their customer's identity prior to opening an account. The genuineness of the customer can be identified through this. It also required frequent updation and the banking sector periodically contacts the customer to get updates

IN-TEXT QUESTIONS

Write True or False against the following

7. Full form of ATM is Any Time Money. (T/F)
8. Term Deposit is another name for Fixed Deposit (T/F)

1.7 VARIOUS TYPES OF LOANS

After accepting deposits form their customers the banks earn interest subsequently by offering them as loans. You need to get knowledge of some of the populartypes:

1.7.1 EDUCATION LOAN

With education in general and higher education in particular becoming expensive, students need to fund their education. Thus, the need to apply for education loan to meet the shortfall in fees and other expenses to fund their education. Financial institutions as well as NBFCs attract borrowers by offering attractive interest rates on repayment

Types of Education Loans

On the basis oflocation, it can be domestic or foreign education loan

On the basis of course it can be secondary, senior secondary, undergraduate or postgraduate

Another way of dividing them could be:

- Loans for Career Enhancement
- Education loan against third party guarantee
- Education loan against property and security

The primary documents needed along with the loan application are:

- KYC documents
- Mark sheets of 10th, 12th, graduation and entrance exams
- Admission letter
- Fee structure
- Co-applicant KYC and income proof in some cases

Additional documents may be requested in some cases.

The borrower can also avail tax benefits under 80E. To apply, the borrower needs to submit the loan application along with the above documents to the financial institution and the process of loan disbursal will start if all things are found in order.

Normally a grace period of 6 months after the completion of the course is given before the repayment process of the loan starts. The maximum time allowed for repayment is 8 years from the date of taking the loan

1.7.2 CONSUMER DURABLE LOANS

A consumer durable loan is a loan offered for the purpose of buying consumer durable products. These are products which have a life of at least 3 years. It is not backed by any security or collateral.

The credit history of the borrower is not significant. The ability to payback i.e., the income of the borrower is more important

Eligibility for this loan:

Age: Usually between21 to 60 years.

Credit: as mentioned earlier the borrower's credit worthiness is not important, the borrower's income is seen

To qualify for the loan, the individual's monthly income must range from 18,000 - 20,000 INR or above.

The Rate of Interest on these loans is very high and are quickly approved

The maximum limit is Rs 5 lakhs and the maximum period of 36 months

Types

Instalment Loans: These are very common and paid back in periodic instalments according to a present timetable. These can be further divided into **Fixed- and variable rate consumer durable loans**

Secured consumer durable loans: For availing thee, a security or collateral is needed Secured loans are those which are secured against assets as collateral.

Unsecured consumer durable loans: For this more common type of loans, no security or collateral needs to be provided. Interest rates for unsecured loans are higher than for the secured loans.

1.7.3 VEHICLE LOAN

These can be classified into personal vehicle loan and commercial vehicle loans. The eligibility conditions and the interest and charges for these vary**.** Personal Vehicle Loan: Personal vehicle range from new and used bikes, scooters to cars required for personal use by individuals. This type of loan does not need any guarantor.These can be taken from banks and finance companies at attractive and competitive rates, both offline and online options for processing of such loans are available. For filling the form to avail the loan, vehicle make and model, manufacture date and attaching the necessary documents for the same. Such loans are available for up to 60 months. Loan is disbursed on the basis of the value of the personal vehicle be it new or used vehicle

Commercial Vehicle Loan

Commercial vehicle loans are loans given to borrowers, usually businesses be it self-employed individuals, or other firms for commercial or business purposes. Again, these could be new or used commercial vehicles

Lower interest rate is charged from bowers whose profile matches the one put out by the lending institution. The documents needed are not too many and the processing time is fast.

Types of Commercial Vehicle Loans

New commercial vehicle loan- For customers wanting to purchase new commercial vehicle for their business. Banks provide 100% funding on chassis or the base frame

Old commercial vehicle loan-These are loans for buying used or old commercial vehicle which is up to 15 years old. People eligible for these loans range from sole proprietors to large corporations

Documents needed for processing these loans are as follows

- **KYC documents**
- Proof of Age- Aadhaar Card/PAN Card/Voter's ID card/Driving License/Passport (Anyone)
- Proof of Identity - Aadhaar Card/Voter's ID card/Driving License/Passport (Anyone)
- Proof of Residence - Rental agreement/Voter's ID Card/Passport/Ration card/Tel bill or Elec. Bill/Trade License/ Sales Tax Certificate (Any one)
- Signature verification proof-Driving License/PAN Card/Registered Sale Deed/Govt. ID Card (For Govt. employees) (Any one)
- **Proof of Income**
- Last 3 months Salary Slips/Last 6 months bank statement/ Form No.16/Updated ITR for last 2 years/
- Photocopy of official ID
- **Proof of Experience**
- **Vehicle details and valuation**
- **Insurance and RC copy**
- **Trade references**
- **Loan repayment track record**

Processing charges- These range from 2% to 4% of the loan amount and non refundable.

Repayment tenure- The repayment tenure for a commercial vehicle loan ranges from 6 months to 60 months (5 years). EMIs are a good option for the borrower.

1.7.4 HOME LOANS

These loans are taken for owning a dwelling in one's own name. Critical savings of the individual can be utilised for other important tasks such as for education**.**

The loans come with a host of benefits and features. However, before applying for home loans, you should be aware of every aspect. So, here you will find some aspects related to the housing loans so that you become aware.

Features and benefits of home loans:

Easy availability: All the financial institutions and NBFCs are offering attractive housing loan schemes. One can avail of the home loan after checking their eligibility to meet his/her requirements. It helps to create a win situation for both the lender and the borrower and also benefits the economy as more cash reaches those who need it- directly as well as indirectly

Multi-Purpose: Housing loans are multi-purpose loans that are available for various purposes such as buying a new residential flat or building, constructing a new house on a plot, home renovation, or extending your current house.

Lower interest rate: Being a secured loan, home loans are generally subject to lower rates of interest as compared to other financing options. In case of problems there is the facility of top up loans.

Fast loan processing: Home loans involve lenient eligibility criteria and minimal documentation. This enables financial institutions and NBFCs to process the loan amount faster. In case the borrower fulfils the basic eligibility criteria, the lending agency goes for quick registration and verification thereby hastening the disbursal process.

Long Tenure: Since the loan amount involved in housing loans is high, the tenure to repay that loan can go up to as high as 30 years. This allows the borrower to choose an affordable EMI and ensure that his monthly budgets are not under any kind of pressure.

Tax benefits: You can claim a tax deduction of Rs. 1.5 lakhs on the principal repayment under Section 80 C and Rs. 2 lakhs on the interest repayment under Section 24 B. You can also claim a home loan tax deduction when you pay for the registration fees and stamp duty charges under Section 80C.

Note: The Union Budget 2020 specifies an additional deduction of Rs. 1.5 lakh for interest repayment on home loan taken by 31 March 2021 under Section 80EEA, to purchase a house costing up to Rs. 45 lakhs. This additional deduction is being provided over and above the existing 2 lakh deduction.

Balance transfer facility: With the help of a home loan balance transfer facility, you can refinance your existing home loan to another bank that is offering lower interest rates or better loan terms.

Top-up loan facility: In a top-up loan facility, you can borrow an additional sum over and above your existing home loan and use it for any personal or business purposes.

Banks	Starting Interest Rate (p.a.)	Processing Fees
Kotak Mahindra Bank	7.50% p.a. onwards	0.50%
Citibank	6.65% p.a. onwards	Rs. 10,000
Union Bank of India	8.25% p.a. onwards	-
Bank of Baroda	7.45% p.a. onwards	Contact the bank for information
Central Bank of India	7.20% p.a. to 7.65% p.a.	Rs. 20,000
Bank of India	7.30% p.a. onwards	-

State Bank of India	8.55% p.a. onwards	0.35% onwards
HDFC Home Loans	8.60% p.a. onwards*	0.5% or Rs.3,000 whichever is higher
LIC Housing Finance	7.55% p.a. onwards	Rs. 10,000 -Rs. 15,000
Axis Bank	7.60% p.a. onwards	Rs. 10,000
Canara Bank	8.10% p.a. onwards	0.50% of the loan amount
Punjab and Sind Bank	7.50% p.a. onwards	Full Waiver
IDFC First Bank	7.50% p.a. onwards	Rs. 5,000 - Rs. 5,000
Bank of Maharashtra	7.30% p.a. onwards	Rs. 10,000
Indian Overseas Bank	7.05% p.a. onwards	0.50% (Max Rs. 20,000)
Punjab National Bank	7.40% p.a. onward	0.35% (Max Rs. 15,000)
United Bank of India	7.50% p.a.	0.59% (Rs. 1,180 - Rs.

	onwards	11,800)
UCO Bank	7.40%	0.15% (Rs. 1,500 - Rs. 15,000)
DBS Bank	7.30%	0.25% (Rs. 10,000)
IDBI Bank	7.60%	0.50% (Rs. 2,500 - Rs.5,000)
HSBC Bank	7.35%	1% (Rs. 10,000)
Karur Vysya Bank	8.05%	Rs. 5,000
Saraswat Bank Home Loan	7.50% p.a. onwards	Nil
Jammu and Kashmir Bank	7.85%	Rs. 500 - Rs. 10,000
South Indian Bank	Repo Rate + 3.35% p.a. onwards	0.50% (Rs. 5,000 - Rs. 10,000)
PNB Housing Finance	7.50% p.a. onwards	Up to 0.50%
Federal Bank	8.55% p.a. onwards	Rs. 3,000 - Rs. 7,500

Standard Chartered Bank	7.25% p.a. onwards	1%
Avaaz Financiers	8.00%	1.00%
Karnataka Bank	7.89% p.a. onwards	Rs. 250
Sundaram Home Finance	6.95%	Rs.3,000 (for salaried)
Dhan Laxmi Bank	8.35% p.a. onwards	Rs. 10,000
Tata Capital	7.75% p.a. onwards	0.50%
Tamilnad Mercantile Bank	7.95%	Rs. 15,000
DHFL Housing Finance	8.75%	Rs. 2500
Bandhan Bank	7.30% p.a. onwards	1% (Rs.5,000)
Yes Bank	8.95%	1% (Rs. 10,000)
Hudco Home Loan	9.25%	NA
Indiabulls	7.60%	0.50% onwards

Aditya Birla	8.00% p.a. onwards	1%
GIC Housing Finance	8.20%	Rs. 2,500
Reliance Home Finance	9.75%	Rs. 3,000 - Rs. 6,500
Shriram Housing	8.90%	NA
India Shelter Finance	13.00%	2.00%

Home loan interest rates for all banks updated on 22 Nov 2022

Source: https://www.bankbazaar.com/home-loan-interest-rate.html

Basic eligibility criteria for a home loan

Home loan eligibility criteria differ from one financial institution to another. However, the basic criteria required to get home loans are given below-

Age: The minimum and maximum age should be at least 18 years or a maximum of 70 years

Income: The minimum monthly income should be at least Rs. 20,000 and above (varies across financial institutions & locations)

Resident Type: The applicant can be either a Resident Indian, Non-Resident India (NRI), or Person of Indian Origin (PIO)

Employment Status: Salaried or Non-Salaried

Credit Score: 750 or above with a good credit history

Loan-To-Value Ratio: 90% of the property value

Work Experience: 2 Years

Residence: Permanent resident or Non-resident Indian (NRI)

Documents required

Application Form: Signed Application form with your latest passport-sized photographs

Proof of Identity: Photocopy of any of the documents such as PAN Card, Passport, Aadhaar Card, Voter's ID Card, and Driving License

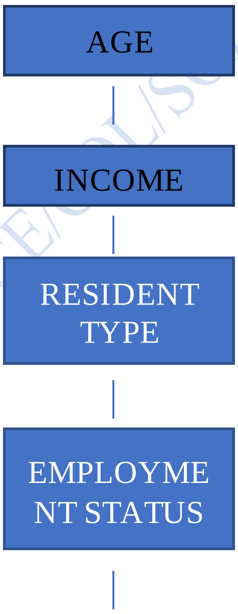
Proof of Age: Photocopy of any of the documents such as Aadhaar Card, PAN Card, Passport, Birth Certificate, 10th Class Mark-sheet, Bank Passbook, and Driving License

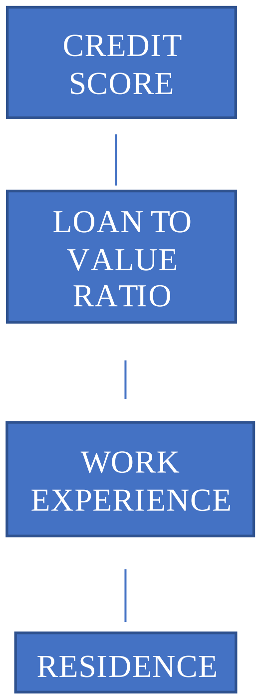
Proof of Residence: Photocopy of any of the documents such as Bank Passbook, Voter's ID, Ration Card. Passport, Utility Bills (Telephone Bill, Electricity Bill, Water Bill, Gas Bill) and LIC Policy Receipt

Proof of Income for Salaried: Copy of Form 16, latest payslips, IT returns (ITR) of past 3 years, and investment proofs (if any)

Proof of Income for Self Employed: Details of ITR of last 3 years, Balance Sheet and Profit & Loss Account Statement of the Company/Firm, Business License Details and Proof of Business Address

Property-related Documents: NOC from Society/Builder, detailed estimate of the cost of construction of the house, registered sale deed, allotment letter, and an approved copy of the building plan





Note: Please note the documents may vary from one financial institution to another. You might be asked for additional documents depending upon your financial institution.

1.7.5 SHORT TERM, MEDIUM TERM AND LONG-TERM LOANS

Loans can also be trifurcated as under:

Short Term- Loans up to a period of 1 year are termed as short-term loans

Medium-Term Loans i.e., loans and advances granted for a period of above 1 year and up to and inclusive of 3 years.

Long-Term Loans i.e., loans and advances granted for a period of above 3 years.

All loans need to be repaid with interest within the agreed upon period or as decided in the written agreement between the borrowing and lending entity

Short term loans are needed to tide over an immediate need for funds or for meeting capital expenditure. The period of term is up to a year. It carries a lower interest rate as compared to other term loans

Long term loans can last from just over a year to 25 years. Some short-term loans don't specify a payment schedule or a specific due date. They simply allow the borrower to pay back the loan at their own pace.

Types

Some common loans are as below:

Merchant cash advances- *These are cash advances cloaked as loans. The borrower takes the specified amount from the lender. The borrower then gives access of his credit facility to the lender every time the borrower's customer purchases something and makes the payment, a part of the payment goes to the lender, this is repeated till the loan take is repaid in full.*

2. Credit Line- *A credit line or credit limit is set to enable the business to use it as and when needed/ Monthly payments are made till the loan amount is paid off in full.*

PayDay loans- As the name suggest, these are loans adjusted against the salary received on pay day. These are short term in nature and are taken in emergency situation. They carry very high interest rate.

Online loans- As is clear from the term these loans are disbursed online. As soon as the loan is approved, the money gets transferred into the borrower's account. These too are short term.

Advantages of Short-Term Loans

There are many advantages for the borrower in taking out a loan for only a brief period of time, including the following:

- Lower rate of Interest
- Quick funding
- Easy to get
- Less documentation

1.8 SUMMARY

In the above unit you have read about the different types of banks operating in India, fulfilling the needs and requirements of different sections of society. They offer a wide range of products and services not only to satisfy the needs of customers and account holders but also enhance their income and meet the stakeholder objectives. You have learnt that banks mobilize funds by offering different types of deposits with differing benefits and interest rates focusing on types of customers they get. Banks also customize their service by offering tailor made loans to different types of customers ranging meeting the demand for loans related to education to consumer durables to housing etc.

1.9 GLOSSARY

- Bill Discounting- The bank takes the bill from the borrower on his customer and after deducting some amount as discount or commission, pays the balance immediately
- Collateral- Any asset given as security to the bank to ensure repayment of loan and it can be seized by the bank in case of non-payment
- Consumer Durable Products- All products expected to have a long useful life after purchase e.g., furniture, appliances etc
- Cooperative Banks- A small sized financial institution whose members are the owners and also the customers of the bank. It operates for the benefit of its members

1.10 ANSWERS TO IN-TEXT QUESTIONS

1. RBI	5. False
2. Commercial	6. True
3. Clearing	7. False
4. Promissory Notes, Bills	8. True

1.11 SELF-ASSESSMENT QUESTIONS

1. Why is Reserve Bank of India called as the Banker's Bank?
2. What role do banks perform between those with extra funds and those needing funds?
3. What are the different types of Banks?
4. Give one example each of commercial, cooperative and development bank
5. Name the different types of Accounts
6. How do you differentiate between Term Deposit and Recurring Deposit

7. Differentiate between used and new commercial vehicle loans.
8. Why are all loan seekers not given loans?
9. What are the key features of savings account?
10. For whom is current account more suited?
11. Differentiate between current account and savings account

1.12 REFERENCES

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1.13 SUGGESTED READINGS

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LESSON-2

FINANCE FROM BANKS AND ELECTRONIC BANKING

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STRUCTURE

2.1 Introduction
2.2 Financing the Businesses
 2.2.1 Microfinance
 2.2.2 Bank OD
 2.2.3 Cash Credit
 2.2.4 Mortgage
 2.2.5 Reverse Mortgage
 2.2.6 Hypothecation
2.3 Agriculture and Allied Activities Interest rates offered by Nationalized banks
2.4 New Technologies and Initiatives in Banking
 2.4.1 Cashless Banking
 2.4.2 E Banking
 2.4.3 Check Counterfeit Currency
 2.4.4 CIBIL
 2.4.5 ATM
 2.4.6 Net Banking
 2.4.7 RTGS
 2.4.8 NEFT
 2.4.9 IMPS
 2.4.10 ECS

2.1 LEARNING OBJECTIVES

After reading this Unit you should be able to:

- Recall the different ways of financing business
- Understand the agriculture related loans and rates offered
- Gain knowledge of banking terms
- Recall system of grievances and complaints

2.2 INTRODUCTION

In the previous Unit you have been made aware of thetypes of banks and the kinds of service that banks offer to their customers. After going through this Unit, you will also be able to identify the different types of finance options available for businesses. You will also get insights into the different interest rates applicable for farm and non-farm sector. Finally, you will get familiarised with the latest initiatives and technologies in Banking and the process of filing complaints.

2.3 FINANCE THE BUSINESSES

Banks help the different strata of the economy by providing funding to different entities ranging from individuals to large corporations. Some of the options are mentioned below for your understanding.

2.3.1 MICROFINANCE

It is a method of finance tailor made for small business esp. those without access or capability to get access to financial institutions and their products and services. Its goal is to make businesses self-sufficient and self-dependent. To take an example Micro Units Development Refinance Agency (MUDRA) gives collateral free loans under three different categories namely Shishu (loan up to Rs 50000), Kishor (between 50000 to 5 lakhs) and Tarun (5 lakhs to 10 lakhs) in the non-farm sector

2.3.2 BANKOVERDRAFT

This service is offered to account holders and is most suited for businesses who needs funds in an emergency, it is a quicker process as compared to applying for loans as much less documentation is needed, and it carries a lesser rate of interest as compared to that of loan. It is an extended credit facility which most bankers offer to their account holders in situations where their balance reaches zero. This helps the account holder tide over extreme need in the short term for critical funds esp. working capital requirement of small and large businesses alike. The interest rate for OD varies with each bank. If the borrower defaults on the payment, the interest rate increases. It is an unsecured loan. It is of two types: Authorised and Unauthorised

Authorised OD – The borrower enters into a prior agreement in writing with the lending institution. When the balance reaches zero the borrowing entity can avail of OD facility.

Unauthorised OD- There is no prior agreement when the balance reaches zero.

2.3.3 CASHCREDIT

This is like a short-term credit given by banks to small and large business entities to enable them to take care of theirworking capital needs. Since its short term, the repayment of the credit taken is within12 months. It is backed by collateral and carries a lesser rate of interest as compared to overdraft.

2.3.4 MORTGAGE

Usually applicable for immovable assets like property, it is a security given by the borrower to ensure repayment of loan. This helps to secure the debt taken. Here there is no transfer of ownership of the asset, only a transfer of interest to ensure that payment is secure and timely. To take an example,

The two parties involved are mortgagor and mortgagee. The mortgagor is the borrower, and the mortgagee is the lender and the money involved is called mortgage money and the document through which the money is transferred is called Mortgage deedSome of the popular kinds of Mortgage are:

- Simple Mortgage where the mortgagor undertakes to pay back the money taken failing which the debt can be realised by selling the asset via court
- Mortgage via conditional sale- If the debt remains unpaid by a certain date, the sale will take place
- Usufructuary Mortgage- Under this, property is given as collateral and it may be used by the lender to repay the loan from the rent proceeds and/or profits generatedfrom using the said property There needs to be an agreement between the mortgager and mortgagee for this type of mortgage to take effect as the mortgagee enjoys the possession and the benefits derived therefrom till the repayment of the borrowed sum happens.
- English Mortgage-In these kinds of mortgage, the mortgager mandatorily agrees to repay the money owed on a certain date. A n agreement takes place between the mortgagee and the mortgagor where the property is transferred in the name of the mortgagee with the provision that the property will be transferred back to the mortgagor once the repayment of the mortgage loan has happened

Mortgage By Conditional Sale

In Mortgage ostensibly sells the mortgaged property, on condition that:

On default of payment of mortgage- money on a certain date, the sale is to become absolute

On such payment being made, the sale is to become void, or the buyer is to transfer the property to the seller. The ownership of the property is with the borrower.

2.3.5 REVERSE MORTGAGE

It is a kind of loan especially suited for senior citizens in need of funds. Potential borrowers over the age of 60 and having their own property can get loan against the property. They get funds against their property in a periodic manner for a certain period of time from the bank.

As the bank pays money periodically to the borrower it is called reverse mortgage. The property is the security against the loan.

Documentation

- Proof of Identity
- Proof of Residence or address
- Employer Identity card
- Property papers
- Account statement of the last 6 months for all bank accounts held
- Loan account statement of the last one year (if any)

2.3.6 HYPOTHECATION

You would have seen a lot of commercial vehicles carrying this slogan at the back "Hypothecatedwith XYZ bank" You would have wondered what it means? Hypothecation is the pledging of goods, against the debt without delivering them to the lender. This term is used widely in the vehicle finance industry esp. where vehicle is purchased, and the same vehicle is used as a security for the loan taken from the financial institution. Thus, the vehicle is the collateral against the loan. The ownership of the asset remains with the lender till the repayment of the loan taken happened. In case of default, the lender can seize the asset back form the borrower. It is usually applicable as you know by now, to moving assets. The possession of the assets lies with the borrower while the ownership is with the lender. The lender is the hypothecator, and the borrower is the hypothecate

Defined in

Section-172 of the Indian Contract Act, 1872

Section-2(1)(n) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

2.3.7 PLEDGE

Bailment of goods as security against the debt for the performance of the obligation or the payment thereon, is known as the pledge

This comes into the picture when the lender or pledgee takes actual possession of the asset. The pledgee retains possession of the goods till the entire loan amount is received.In case of default the pledgee has the right to sell the goods in possession and adjust against the outstanding dues.

IN-TEXT QUESTIONS

Fill in the blanks against the following:

1. For interest on education loan the borrower can claim relief under Sec ……. Of the Income Tax Act while filing returns
2. Consumer Durable products are products that last for at least …. years

2.4 AGRICULTURAL AND ALLIED INTEREST RATES OFFERED BY VARIOUS NATIONISED BANKS

You are already aware that agriculture is one of the primary sectors of the economy. Agriculture is not limited to the farming alone. It also includes aspects like forestry, animal husbandry, poultry, fisheries and aqua culture, floriculture, horticulture, sericulture etc. For the economy to grow it is essential that agriculture sector also develops.

Policy initiatives by the government has transformed into the banking sector offering agricultural loans at very competitive rates. Some of the nationalised banks offering interest rates are as given below:

Name of the Bank	Interest Rate	Processing Fee
Central Bank of India (Cent Kisan Tatkal Scheme)	8.70% p.a. onwards	Up to Rs.25,000 – Nil Above Rs.25,000 - Rs.120/- per lakh or part thereof Maximum: Rs.20,000
IndusInd Bank (Crop Loan)	10.15% - 14.75% p.a.	Up to 1% plus service tax
HDFC Bank (Retail Agri Loans)	9.10% - 20.00% p.a.	2% to 4% or Rs.2,500
Federal Bank (Federal Green Plus Loan Scheme)	11.60% p.a.	As per the lender’s terms and conditions

Union Bank of India (Land Purchase Loan)	8.70% p.a. onwards	Up to Rs.25,000 - Nil
Karur Vysya Bank (Green Harvester)	10.30% p.a.	As per the lender's terms and conditions
Canara Bank (Kisan Suvidha Scheme)	10.10% p.a.	As per the lender's terms and conditions
Andhra Bank (AB Kisan Rakshak)	13.00% p.a.	As per the lender's terms and conditions
UCO Bank (UCO Kisan Bhoomi Vridhi)	3.10% - 3.50% p.a.	Nil up to Rs.3 lakh

In addition, it is also important for you to note that different reasons why loans might be needed for the allied activities at the farm itself. Loans are on offer for farm mechanisation, financing harvester combines, minor irrigation, and also provide finance through primary credit societies and Self-Help Groups or SHGs. Crop loans, Agri loans, solar pump set loans and tractor loans along with land development loans are equally popular.

Loans for allied activities offered by SBI the leading bank in the country start from10.3% pa. It offers interest @ 7.25% for crop loans pledge against gold ornaments, 10 to 10.6% for tractor loan, for MUDRA 9.75%, for plantation, dairy, poultry, irrigation and land development, it is 10.6 %

Given below is a snapshot of loans for agriculture and allied activities by few banks:

Some of the banks who provide Agriculture Loan India

Name of the bank	**Agriculture loan schemes offered**
State Bank of India	• Crop Loan • Kisan Credit Card • Multipurpose Gold Loan Tractor Loan

	• Combine Harvester Loan • Drip Irrigation Loan • Dairy Loan • Poultry Loan • Fisheries Loan • Produce Marketing Loan • Setting up of Agri Clinic and Agri Business Centers • Land Purchase Scheme • SBI Krishak Uthan Yojana • Scheme for Debt Swapping of Borrowers
National Bank for Agriculture and Rural Development (NABARD)	• Capital Investment Subsidy Scheme for Commercial Production Units for organic/ biological Inputs • Agriclinic and Agribusiness Centres Scheme • National Livestock Mission
Karur Vysya Bank	• Green Card / Green Card Plus (Kisan Card) • Green Harvester • Green Trac • Warehouse Receipt Loan • Jewel Loan • Kisan Tatkal • Green Car • Loans for Horticulture Projects • Two-Wheeler Loan

	• Dairy Loan • Poultry Loan • Pisciculture Loan • Loans for SHG-JLG
IndusInd Bank	• Production Loan (CC) • Investment Loan (TL) • Hi-Tech Agriculture (OD) • Hi-Tech Agriculture (TL)

Name of the Bank	**Interest Rate**	**Processing Fee**
Central Bank of India (Cent Kisan Tatkal Scheme)	8.70% p.a. onwards	Up to Rs.25,000 – Nil Above Rs.25,000 - Rs.120/- per lakh or part thereof Maximum: Rs.20,000
IndusInd Bank (Crop Loan)	10.15% - 14.75% p.a.	Up to 1% plus service tax
HDFC Bank (Retail Agri Loans)	9.10% - 20.00% p.a.	2% to 4% or Rs.2,500
Federal Bank (Federal Green Plus Loan Scheme)	11.60% p.a.	As per the lender's terms and conditions
Union Bank of India (Land Purchase Loan)	8.70% p.a. onwards	Up to Rs.25,000 - Nil
Karur Vysya Bank (Green Harvester)	10.30% p.a.	As per the lender's terms and conditions
Canara Bank (Kisan Suvidha Scheme)	10.10% p.a.	As per the lender's terms and conditions

Andhra Bank (AB Kisan Rakshak)	13.00% p.a.	As per the lender's terms and conditions
UCO Bank (UCO Kisan Bhoomi Vridhi)	3.10% - 3.50% p.a.	Nil up to Rs.3 lakh

IN-TEXT QUESTIONS

Write True or False against the following:

11. Under the category of agriculture, preference is given to farm loans than to other loans (T/F)

2.5 NEW TECHNOLOGIES AND INITIATIVES IN BANKING

2.5.1 CASHLESS BANKING

Cash, be it coins or currency, manufacturing as well as handling them, is a costly affair. There are inherent risks associated with cash handling and transfer and the costs overrun the benefits. Topromote and empower the economy, the GoI has introduced Cashless Banking more so in Bank-to-Bank dealings. It has now trickled down to the other strata of society. It includesPlastic money like Debit Cards and Credit Cards, Mobile Wallets etc. You need to be aware and below you will get basic knowledge of some of the tools that has helped in the growth of cashless banking in India

Bank Cards, like Debit Cards and Credit Cards are the most popular cashless payment methods.

Unstructured Supplementary Service Data(USSD) is tailormade for those without a smartphone. Payment can be made without smartphone or internet.

QR Code- The term QR stands for Quick Response through which consumers scan the QR code of the merchant to complete the transaction. It's a square grid containing pattern of black squared and is read by imaging devices like smartphone cameras.

Mobile Wallet- They are fast, risk free and convenient, through which people are able to transactand store emoney by simplylinking it to their respective bank account. The user can make any kind of payment by simply entering phone number, email, unique code or scanning QR code (explained earlier).

2.5.2 E BANKING

Banking using electronic mode is called electronic banking or E Banking for short. It is synonymous with virtual baking, online banking. Here the telecom network is utilized for bank related work via computes or even mobiles

Through E banking banks offerservices like mobile banking, ECS, Smart Cards. EFTs, Telebanking, mobile banking etc.

Mobile Banking:

Mobile banking (otherwise called M-banking) is a name utilized for performing account exchanges or transactions, bill payments, credit applications, balance checks, and other financial exchangesthrough a mobile phone like a Personal Digital Assistant (PDA) or cell phone.

Electronic Clearing System (ECS):

The Electronic Clearing System is a creative provision for occupied individuals. With this provision, an individual’s credit card bill is consequently charged from the same individual’s savings bank account, so one doesn’t have to stress over missed or late payments.

Smart Cards:

A smart card is a card that stores data on a microchip or memory chip or a microprocessor in lieu of the magnetic stripe found on debit cards and credit cards. Smart cards are not utilized for transferring or moving monetary data alone, but also, they can be utilized for an assortment of identification grounds. Exchanges made with smart cards are scrambled or encrypted to shield the exchange of data from one party to another. Each encoded exchange can’t be hacked and doesn’t transmit any extra data past what’s required for finishing the single exchange or transaction.

Electronic Fund Transfers (ETFs):

Electronic fund transfer (EFT) is the electronic exchange of cash starting with an individual account in the bank to another individual account of the same bank, or within or with other financial institutions or with multiple institutions, by means of personal computers-based frameworks, without the immediate intercession of bank staff.

Telephone Banking:

Telephone banking is an assistance given by a bank or other monetary foundation or other financial institutions, that empower clients to perform via telephone a scope of monetary exchanges which don't include cash or financial instruments, without the need to visit an ATM or a bank branch.

Internet banking:

Web-based banking is an assistance presented by banks that permits account holders to get their record information by means of the web or the internet. Web-based banking or Internet banking is otherwise called "Web banking" or "Online banking."

Internet banking through customary banks empowers clients to play out every standard exchange, for example, bill payments, balance requests, stop-payment requests, and balance inquiries. Some banks even proposition online credit card and loan applications.

Account data can be acquired day or night and should be possible from any place.

Home banking:

Home banking is the most common way of transacting from your own house as compared to the inconvenience of visiting a bank's branch. You are able to make account requests, deal in cash, pay bills, apply for credits, by just pushing a few buttons at your time and pace.

The benefits are convenience, easy access, 24X7 availability, physical visit and interaction avoided. It is less costly for the bank as paperwork gets reduced, physical transfer and risk associated with cash is vastly reduced

2.5.3 CHECKING COUNTERFEIT CURRENCY

The central bank or RBI alone has the mandate to print and issue legal currency in India. Counterfeit currency means currency made without the sanction of the GOI, deliberately in an effort to make easy money and to mislead the receiver. These are also called as Fake Currency Notes (FCNs). Several measures have been put in place to identify such currency. Some of them are indicated below:

Where the notes have been color printed, the thread would be missing. The ink too would not be of the same quality

Watermark of Mahatma Gandhi is visible against light, in fake currency, the watermark would be thicker

Security Thread in the currency in notes of Rs 5 to 50 contains embedded thread carrying "Bharat" on it. Other old notes have only the thread visible

Image of the value of the currency note- For Rs 20 to Rs 500, the denomination value is visible in the image form

Raised Printing- The RBI governor sign on Rs 20 to Rs 500 can be felt on touching as it is in raised print

Figures and Alignment- the real notes have perfect alignment of figures. Close observation of gaps between figures reveals whether the note is real or fake

Ink Smudges- Fake notes may have ink smudges and broken lines

Typography- In real notes the Typography of Reserve Bank of India would be smooth, while in fake notes it would be thicker

2.5.4 CIBIL

All of you must have come across this termin mass media but are largely unaware of its full form and its activities. It stands for Credit Information Bureau India Ltd. It provides, as the name suggest, credit related information about individuals and companies related to loans and credit cards.

It is the first Credit Bureau formed in India. It gets records from registered financial institutions periodically. On this basis, it analyses and then issues Credit Information Report to enable banks and other lending institutions to enable them to filter loan applications. It has the borrowers' history in detail and whether they have fulfilled their debt obligations in the past and their track record.

2.5.5 ATM

Popularly called in layman language as Any Time Money, it actually stands for Automated Teller Machine. As the name means, it is a machine that helps to manage the money of the account holder. Payments and Deposits can be made through this without visiting the bank branch.

The user individually can gain access to his account to get updated about the latest amount in his account,

For money transactions either a debit card or credit card is used, and PIN authentication might be needed in certain cases

2.5.6 NET BANKING

Internet banking or net banking for short is another servicesystem offered by banks for the convenience of the customer. Through this information about the banks and banking system can be accessed anytime, in real time.funds transfer via the Internet.

The physical visit to the nearest branch is avoided saving the hassle of travel, parking, rush, time taking transactions and the waiting period in the queues etc. in the branch.

The benefits offered are convenience, anytime access, information availability in a few clicks along with necessary action. tracking of information and transactions as and when done, speedy transactions involving money. The account holder can register for it offline or online.

2.5.7 RTGS

As the name suggests, immediate transfer of funds and/or securities takes place. RTGS means Real Time Gross Settlement. This too is an electronic route of funds transfer. It is actually a continuous process of settling the payments. Transactions are handled individually and not grouped together. It is primarily for huge bank to bank transfers, operated under the watchful eyes of the central bank. Once the transactions are completed, they cannot be reversed.

2.5.8 NEFT

The full form of NEFT is National Electronic Funds Transfer. As the name suggests, it is a nationwide platform for making payment. It is quite easy to use, and no physical transfer is involved so the risk and inconvenience associated with it are avoided. Due to the penetration of online banking in the country it is also gaining in popularity

To avail this service the bank IFSC code needs to be mentioned along with the name of the account holder, account number and the name and branch of the bank to which the funds need to be transferred

2.5.9IMPS

Also called as Immediate Payment System, it is a service by the bank. It was a pilot mobile payment system initially and offers quick electronic funds transfer service through mobiles.

Mobile banking or SMS are utilized for this, and accounts can be accessed using mobiles. To use this service the customer must first register with the IMPS service of the bank. It is very convenient for the user and a quick method of fund transfer

2.5.10ELECTRONIC CLEARING SERVICE

As the name suggests, funds are transferred electronically. This service is used for transactions which are periodic and repetitive e.g., utility bills like telephone bills, electricity bills, water bills etc. It is quicker method as compared to physical transfer of cash. ECS credit and ECS debit are the two variants offered by banks under this.

ELECTRONIC FUND TRANSFER

As the name suggests, for these transactions' computer networks are used for accounts at the same bank and even for accounts at different banks. For this customer, from anywhere can used their mobiles or the internet for making funds transfers. It is a secure and safe method for making payment. Physical transfer of funds is easily avoided, and the risk too gets reduced. Mistakes too can be avoided. Electronic Clearing Houses are used for processing transactions. NEFT, RTGS and IMPS are the routes through which the funds are transferred.

2.5.11 DEBIT AND CREDIT CARDS

A debit card is a cashless route of making payment. It debits money from a customer's account directly when it is used. It may be used to buy products and services and to make payments or for cash withdrawing form ATMs. Unlike credit cards the customer cannot use more than what is available in their account. So, that limitation is there and is an advantage or disadvantage as per the view of the customer.

To use these unlike credit cards, the user does not have to pay any fees or charge.

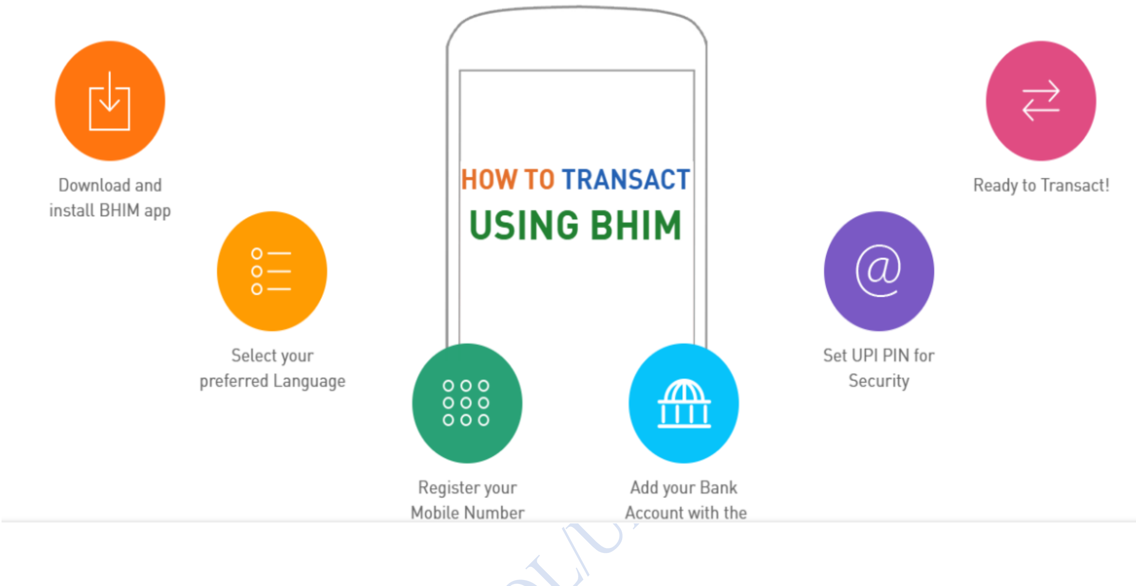
Credit Cards on the other hand are cards used for payment like debit cards, but the user has to promise the card issuing authorities that payment and other charges levied will be processed.

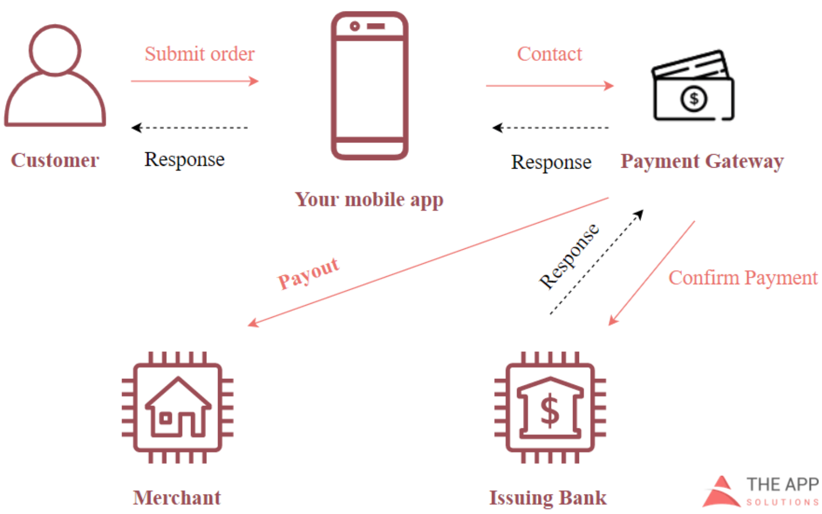
The card issuing authority gives a line of credit to the card user through which the payment can be made for purchase of products and services. The issuing authorities also enter into agreements with sellers to accept these cards as mode of payment. Through electronic verification the seller can verify that the card is valid and acceptable as a mode of payment

2.5.12 APP BASED PAYMENT SYSTEM

You have seen the rise in the number of consumers using Apps on their mobiles or computers for making payments, be it everyday articles like ready to eat food, stationery etc. or durables like footwear, mobiles etc. It is interesting to note how this work. While using the app to send your card information through the App to the payment gateway, which in turn sends the information to the card issuing bank, which sends the request to your payment system like MasterCard, VISA etc. After that your reputation is analyzed along with terms and conditions. Then an authorization code is sent to complete the payment and if all goes well, money is transferred to the seller's bank account.

All this takes place in a few seconds, subject to internet speed. You are also able to track the status of your purchase online.





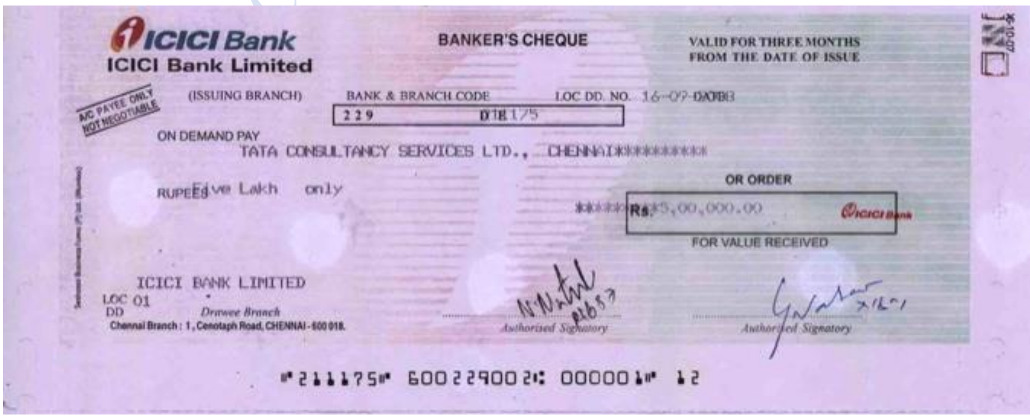
Two kinds of products are on offer- virtual good and physical goods. Also, with this money can be transferred from one account to another as well as services can be availed.

2.5.13BANK DRAFT AND PAY ORDER

Bank draft also called as Demand Draft or DD is a type of negotiable instrument. Here the bank itself stand guarantee for the payment as and when the DD is presented. There is nil chance of dishonor as the payment has been made in advance. The DD can be made at any bank branch by paying in cash even of the customer does not have an account in that bank branch. It can also be realized at any branch of the bank which has drawn the DD anywhere in the country. For this service the bank charges an amount from the person getting the draft made. For amounts above 50K, copy of PAN needs to be attached.

Source: https://en.wikipedia.org/wiki/Demand_draft

Pay order or banker's cheque too is a financial instrument but is different from the draft in that the pay order can be realized only in the city in which the pay order has been made.



SOURCE: https://www.slideshare.net/bijoy12/bank-draft-and-pay-order

ACTIVITY

Visit a nearby bank branch to find out the charge for getting DD made in the following situations:

a. By paying cash
b. Applying through customer account
c. b

2.6 HANDLING BANKING COMPLAINTS

If any customer is not satisfied with any service of the bank, a complaint can be filed on plain paper or on the portal. For this the banking Ombudsman needs to be contacted. The complaint should have the contact details of the complainant. and the bank, facts as per the complainant, loss if any suffered, and if any relief is required. This needs to be done only when the bank has rejected the complaint or has not responded to the complaint, or if the complaint is not satisfied by the bank's response or there is a delay as specified by the RBI.

In this case the complainant or an authorized representative can contact the Ombudsman

Customers can contact the Digital Complaint Management System Portal for any banking, NBFC or even digital related issues

2.6.1BANKING OMBUDSMAN

In 1995, to protect the consumers against unfair practice by the banks, the RBI introduced the Banking Ombudsman scheme.

The RBI has appointed officersto act as banking Ombudsman for speedy resolution of complaints against banks. If in case the reply from the bank is not received within 30 days or the complaint is rejected by the bank the customer can file, the complaint with the banking Ombudsman

2.7 SUMMARY

In the above unit you have read about the different types of finance options provided by banks operating in India, you have also read that Agriculture loans are the main source of banks operating in semi urban and rural areas. They offer loans for a wide range of Agri related activities from seeding to harvesting and sometimes offering customizedadvice. More and moe banks are turning digital and therefor the need for you to become familiar with the latest terms and technologies. You as the consumer are also aware now of what to do in case of deficiency in customer service and the process of filing complaints against the bank.

2.8 GLOSSARY

- Bill Discounting- The bank takes the bill from the borrower on his customer and after deducting some amount as discount or commission, pays the balance immediately
- Collateral- Any asset given as security to the bank to ensure repayment of loan and it can be seized by the bank in case of non-payment
- Consumer Durable Products- All products expected to have a long useful life after purchase e.g., furniture, appliances etc
- Cooperative Banks- A small sized financial institution whose members are the owners and also the customers of the bank. It operates for the benefit of its members
- ECS- It is an electronic method of clearing receipts and payments and is much faster that physical checks and clearing
- Foreign Exchange Mechanism-Mechanism to manage the foreign exchange of a country. It is regulated by RBI
- Hypothecation- Pledging of an asset as a security to take a loan
- KYC-It is a standard designed to protect financial institutions against fraud and misrepresentation
- Pledge- Quite similar to hypothecation,the borrower or another person given an asset as security against the loan with the understanding that the asset may be sold off to settle the outstanding in case of default

2.9 ANSWERS TO IN-TEXT QUESTIONS

1.80E 2. 5	3. False

2.10 SELF-ASSESSMENT QUESTIONS

1. Which allied activities of agriculture are considered suitable for loans?
2. What is the difference between bank draft and pay order?
3. Write short notes on the following:
   a. Mortgage
   b. Reverse Mortgage
   c. Hypothecation
   d. Bank Overdraft
4. What do you understand by cashless banking?
5. Differentiate credit cards from debit cards
6. What is ECS? Why is it gaining importance?

2.11 REFERENCES

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2.12 SUGGESTED READINGS

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Unit-III

LESSON-1

FINANCIAL SERVICES FROM INDIA POST

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STRUCTURE

1.1 LEARNING OBJECTIVES

This unit aims at explaining the basics of savings schemes, remittances and payments banks with the help of services offered by Department of Posts in the nature of Post Office Savings Schemes, India Post Payment Bank and Money Remittance Services.

The objectives of this unit are:

- develop an understanding of the basic differentiating factors that set one Post Office Savings scheme apart from others
- identify relevant feature of various Post Office Savings Schemes
- understand the basics of money transfer and remittance services offered by India Post
- appreciate the reasoning behind setting up of India Post Payments Bank and services rendered by India Post Payments Bank

1.2 INTRODUCTION

The benefits of saving are a keenly discussed topic in our society. In India, there are several options available to a person who wants to save some amount of money. Post office Savings Schemes are one such option and this lesson describes the various savings schemes offered by Post offices.

In case you are wondering why India Post assumes importance in the context of savings schemes, insurance, remittance services etc. you need to remember that the Department of Posts (India Post) has a network of more than 1,50,000 Post Offices and is the largest postal network in the world.

There are 9 different savings schemes offered by Post offices. It is useful to understand these schemes as they offer several benefits in the form of high interest, tax planning etc. Thus, for handling one's own personal finance, it is important to know about Post office Saving Schemes.

Suppose you are a salaried employee faced with the question of where to invest? What are the issues you would keep in mind before making any decision? Rate of interest that is at what rate would your savings grow would be one, then you would also be concerned about the safety of your savings so that you are reasonably certain that your hard-earned money is in safe hands. You would also try to find out which schemes you are eligible to invest in? What is the frequency of payment of interest? This lesson would help you understand Post Office Savings Schemes from all these perspectives.

1.3 HOW TO COMPARE SAVINGS SCHEMES?

Let us continue from the illustration above. When you are deciding where to invest, there would typically be many considerations. Wouldn't it be helpful to have a list of factors that you can use to compare saving schemes? After all, a decision to invest without any comparison may lead us to invest in a scheme that is not suitable for our goals. Such a decision may also lead to us investing greater proportion of our surplus in a scheme than we should have. Thus, it is important first of all to know how to compare savings schemes. What are the features or characteristics to check and watch out for? Once we have such a list ready, comparison becomes a simple exercise, and our decisions would certainly become much more informed and beneficial in the long run.

1.3.1 Eligibility:

Savings schemes in general and Post Office Savings Schemes in particular, like other services and products are formulated with a customer segment in mind. Let us consider a situation wherein Vikas a government employee due to retire in one year and his daughter Mala a fresh graduate who has just joined her first job are both considering where to invest. Do you think the needs and expectations of Vikas, and Mala would be the same? Obviously not. Typically, someone who is about to retire will be more concerned about preserving the corpus of money he or she has saved even if it means little less in terms of interest. It is this difference among needs and expectations of people that leads savings schemes to be launched with particular customer segments in mind. Therefore, perhaps the first and fundamental question we need to ask is: am I eligible to invest in a particular Savings Scheme?

As we will discuss later in this lesson, age and gender are two important factors that determine eligibility to invest in Post Office Savings Schemes.

ACTIVITY

Visit the website of Department of Posts and prepare an exhaustive list of criteria on the basis of which eligibility to invest in Post Office Savings Schemes has been defined.

1.3.2 Rate of interest:

From the perspective of account holder or investors, interest can be understood as the compensation or incentive that an organization offers to account holders or investors for investing money in its schemes.

Post Office Savings Schemes differ with each other on this criterion too. Another important factor is the periodicity of interest – is the interest calculated on annual basis or quarterly basis or monthly basis and so on and so forth. We know from basic arithmetic that compounding of interest/ amount leads to greater growth in invested amount. Basically, compounding means earning interest over interest. In this context, the periodicity of interest becomes important because it tells us how regularly a certain interest rate will apply to an invested amount. Let us consider an example:

10% interest compounded annually on Rupees 100/- would mean that Rs 100/- would grow to Rs 110/- after one year (100 + (10/100 * 100)) and Rs 121/- after two years (110 + (10/100*110)).

1.3.3 Maturity:

In schemes where a sum of money or a series of sums of money are invested for a particular period, the investment is said to "mature" after a particular period. Typically, an investment that has matured can be withdrawn. It is important to find out information related to the time taken till maturity as it will help us in planning our expenditure and savings better.

1.3.4 Tax treatment:

Interest earned from certain schemes and investment in certain schemes are both eligible for differentiated income tax treatment. Typically, interest up to a certain amount is exempt from income tax. Similarly, investment in certain saving schemes can be used for deduction in taxable income. This is also called rebate in income tax.

1.3.5 Other factors:

Besides the above, possibility of premature closure, minimum/maximum amount that can be invested, additional facilities are other factors that can be used to compare savings schemes including Post Office Savings Schemes.

IN-TEXT QUESTIONS

1. There are very limited options to save money available in India. True/False
2. Needs and expectations of all investors are fairly similar. True / False
3. _____ is the incentive that a Bank offers to account holders for investing money in its schemes.
4. _____ means the period after which an investment can be withdrawn.

1.4 TYPES OF POST OFFICE SAVINGS SCHEMES

1.4.1 Post Office Savings Account (SB):

A Post Office Savings Account (SB) as the name indicates is an account which can be used to save money and carry out day to day transactions.

This account can be opened with Rs 500/- by a single adult or two adults (Joint A or Joint B) or a guardian on behalf of minor (person less than 18 years of age) or a guardian on behalf of person of unsound mind or a minor (person less than 18 years of age) above 10 years in his own name.

Joint A or Joint B

The difference between Joint 'A' and Joint 'B' account is important. Joint 'A' account is one that can only be operated by depositors jointly, so, for instance during withdrawal, signatures of both joint depositors are needed on withdrawal slip; Joint 'B' account on the other hand is one that can be operated by any one of the joint depositors.

Nomination is mandatory at the time of opening of account. What does nomination mean? It basically means a facility by which an account holder can "nominate" a person (called the "nominee") to whom the balance in the account should be paid in the event of death of the account holder.

Remember, we have seen above that Post Office SB Account can be opened with minimum Rs 500/-. What happens if the account is opened with Rs 500/- but the balance reaches below Rs 500/-? In such a case, if the account balance is not raised to Rs. 500, then at the end of financial year Rs. 100/- is deducted as Account Maintenance Fee and if account balance is insufficient, the account will be closed.

Interest at the rate of 4% per annum, is payable on the basis of minimum balance between 10th of the month and end of the month. Interest is credited in account at the end of each Financial Year.

Rate of interest payable on Post Office Savings Schemes

Savings Schemes offered by India Post are actually offered on behalf of Ministry of Finance. All deposits received under Post Office Saving Schemes are credited to the National Small Saving Fund (NSSF). The rate of interest payable on Post Office Savings Schemes is notified on quarterly basis by the Ministry of Finance.

Under Income Tax Act, from all Savings Bank Accounts, interest up to Rs. 10,000 earned in a Financial Year is exempted from taxable Income.

Additional Facilities available on PO Savings Account include Cheque book, ATM Card, internet banking etc.

IN-TEXT QUESTIONS

1. The rate of interest payable on Post Office Savings Schemes is notified by the Ministry of Commerce. True/False
2. Joint 'A' account is one that can be operated by any one of the depositors. True/False
3. Post Office SB Account can be opened with minimum Rs. _____.
4. _____ is the person to whom the balance in an account is paid in the event of death of the account holder.

1.4.2 5-Year Post Office Recurring Deposit Account (RD):

"Recurring" means happening regularly rather than once. Thus, RD schemes are intended to encourage individuals to save regularly. RD account can be opened with minimum Rs 100/- per month or any amount in multiples of INR 10/-.

This account can be opened by a single adult or two adults jointly (Joint A or Joint B) or a guardian on behalf of minor (person less than 18 years of age) or a guardian on behalf of person of unsound mind or a minor (person less than 18 years of age) above 10 years in his own name.

Interest rate currently is 5.8% compounded quarterly. Since RD means a chain of deposits, subsequent deposits after opening the account depend on when the RD account was opened. If RD account is opened from 1st to 15th of a calendar month, subsequent deposits should be made up to 15th day of a month. If RD account is opened between 16th and last working day of a month, subsequent deposit should be made up to last working day of a month.

Due to receipt of arrears of salary or allowance or a onetime gain, it is possible that the account holder wants to deposit more than one RD instalment in advance. To facilitate such deposits, there is ample scope for advance deposit. In fact, advance deposit of up to 5 years can be made in an RD account. Rebate (concession) is offered if advance deposit of at least 6 instalments is made. Such rebate for every Rs 100 is Rs 10/- for 6 instalments and Rs 40/- for 12 instalments.

In case of default in payment of RD instalment, default fee is charged for each defaulted month, at the rate of Rs 1/- rupee for every Rs 100/- instalment. From any deposit made after a default, first the default fee is charged, and then monthly RD instalment is accepted. After 4 regular defaults, the RD account becomes discontinued and can be revived within two months from 4th default but if the account is not revived within this period, no further deposit can be made in such account and account remains discontinued.

An added facility of RD account is the facility of loan against deposits made in the past to RD account. This facility can be availed after 12 instalments have been deposited. The loan so available is to the extent of up to 50% of the balance credit in the RD account. Interest charged on such loan is 2% + RD interest rate. Such loan can be repaid in one instalment or in equal monthly instalments.

If we go back to the title of this section, we will find mention of "5 years" before Post Office RD Account. This period of "5 years" refers to the time it takes for maturity. Remember from 1.3.3 (Maturity) that in schemes where a sum of money or a series of sums of money are invested for a particular period, the investment is said to "mature" after a particular period. An investment that has matured can be withdrawn. In case of RD account, the maturity period is 5 years (60 monthly deposits) from the date of opening. There is an option available for extension of RD account by further 5 years. If this option is exercised, the maturity would be 5+5 = 10 years from the date of opening.

IN-TEXT QUESTIONS

1. RD account can be opened with minimum Rs 100/- per month or any amount in multiples of INR 10/-. True/False
2. The usual maturity period of a RD account is 10 years. True / False
3. Interest charged on loan on RD account is __ % + RD interest rate
4. Advance deposit of up to __ years can be made in an RD account.

1.4.3 Post Office Time Deposit Account (TD):

Time Deposit – isn't the term so easy to understand? You deposit a certain sum of money for a certain period of time and at the end of this period, you get the maturity amount. It's that simple.

Interest on all TD accounts is payable annually but calculated quarterly. Minimum amount for opening a TD account is Rs 1000/- and more can be invested in multiple of 100. There are four options in terms of period, in TD account: 1 year TD, 2-year TD, 3 year TD and 5 year TD. The current rate of interest for these terms is as follows:

Period	Rate of Interest
1 year	5-5%
2 years	5.7%
3 years	5.8%
5 years	6.7%

This account can be opened by a single adult or two adults jointly (Joint A or Joint B) or a guardian on behalf of minor (person less than 18 years of age) or a guardian on behalf of person of unsound mind or a minor (person less than 18 years of age) above 10 years in his own name.

5 years TD is special in one respect: one can claim an income tax deduction by investing money in the 5-year TD, under Section 80C of the Income Tax Act, 1961.

Like RD account, there is a possibility of extension of TD account as well. On maturity, a depositor can opt to extend the TD account for another period same as the period for which the account was initially opened. For example, if you have opened a 1-year TD account, you can apply for extension for another 1 year. In case such extension is opted, interest rate applicable on the TD account on the day of maturity shall be applicable to the extended period.

Since TD account involves "locking-in" an amount for a specific period, there is a chance that the account holder may want to close the TD account before maturity. This is called premature closure of account. TD accounts may be closed prematurely after 6 months in case of 1 year TD and after 1 year in case of 2, 3 and 5 year TD. In the first case (1 year TD closed after 6 months), rate of interest payable would the same as on Post Office SB which is currently 4% per annum. In the second case (2, 3 or 5 year TD closed after 1 year), the interest payable is TD interest rate 2% for completed year and for part period less than one year, Post Office SB interest rate is payable. Let us understand this with the help of two examples:

Rate of interest payable on Post Office TD accounts in case of premature closure

Date of opening of account	Date of premature closure	Rate of interest payable
1 year TD: 1st January, 2021	1st July, 2021	4%
2 year TD: 1st January, 2021	1st July, 2022	3.7% (5.7 – 2) for the period from 1st January 2021 to 31st December 2021 and 4% from 1st January, 2022 to 30th June, 2022

IN-TEXT QUESTIONS

1. TD account can be opened for 1 year, 2 years, 3 years and 5 years. True/False
2. The minimum amount for opening a TD account is Rs 1,000/-. True / False

1.4.4 Post Office Monthly Income Scheme Account (MIS):

If you have a substantial sum of money you may want to invest it in a manner that pays you a certain sum on regular (monthly) basis. MIS is intended to cater to such requirement. This account can be opened by a single adult or two adults jointly (Joint A or Joint B) or a guardian on behalf of minor (person less than 18 years of age) or a guardian on behalf of person of unsound mind or a minor (person less than 18 years of age) above 10 years in his own name.

MIS account can be opened with a sum of money in multiples of Rs. 1,000/- and the maximum investment limit is Rs 4.5 Lakh in single account and Rs 9 Lakh in joint account. The rate of interest is 6.7% per annum payable monthly. Let us see how MIS account works in practice:

MIS in practice- timelines:

- Sameer opens an MIS Account opened with Rs. 4,50,000/- on 1st January 2022
- From 1st February 2022 onwards, Sameer will get monthly payment of Rs 2,513/- (assuming rate of interest of 6.7% per annum payable monthly) for 5 years
- On maturity, the principal amount of Rs 4,50,000/- will be paid back to Sameer.

Interest is payable on completion of a month from the date of opening and every subsequent month till maturity. If the interest payable every month is not claimed by the account holder such interest does not earn any additional interest.

There is an option of premature withdrawal after 1 year from the date of deposit. The deduction applicable on the invested amount on premature closure of MIS account is as follows:

- If account is closed after 1 year and before 3 years from the date of account opening, a deduction equal to 2% from the principal will be deducted.
- If account is closed after 3 years and before 5 years from the date of account opening, a deduction equal to 1% from the principal will be deducted.

IN-TEXT QUESTIONS

1. MIS account can be opened for 3 years and 5 years. True/False
2. The maximum amount in a MIS joint account is Rs 4.5 Lakh. True / False

1.4.5 Senior Citizen Savings Scheme (SCSS):

As the name indicates, this scheme is meant primarily for senior citizens i.e., individuals above 60 years of age. Besides, retired Civilian Employees above 55 years of age and below 60 years of age and retired Défense Employees above 50 years of age and below 60 years of age are also eligible provided investment in the scheme is made within 1 month of receipt of retirement benefits.

Minimum deposit under the scheme is Rs. 1,000/- and more can be deposited in multiples of 1,000 subject to maximum limit up to Rs. 15 lakhs in all SCSS accounts opened by an individual. Interest rate on SCSS is 7.6 % per annum payable quarterly.

One can claim an income tax deduction by investing money in SCSS, under Section 80C of the Income Tax Act, 1961. We have discussed that in MIS, interest is paid on monthly basis. In case of SCSS, interest is payable on quarterly basis and applicable from the date of deposit to 31st March/30th June/30th September/31st December.

Like MIS, maturity period of SCSS also is 5 years after which the principal is repaid to the account holder. In case of premature closure of SCSS account, following rules apply:

- If an account is closed before 1 year, no interest shall be payable and if any interest has been paid, it shall be recovered from the principal amount.
- If the account is closed after 1 year but before 2 years from the date of opening, an amount equal to 1.5 % will be deducted from the principal amount.
- If the account is closed after 2 years but before 5 years from the date of opening, an amount equal to 1 % will be deducted from principal amount.

IN-TEXT QUESTIONS

1. SCSS account can be opened by anyone above the age of 55 years. True/False
2. The maximum amount in SCSS accounts is Rs 9 Lakh. True / False
3. Interest is paid on a ______ basis in SCSS account, whereas it is paid on a ____ basis in MIS account.

1.4.6 Public Provident Fund Account (PPF):

PPF account is perhaps one of the most well-known schemes. It is a long-term (15 years) scheme that encourages regular savings. A PPF account may be opened by any adult or a guardian on behalf of minor/ person of unsound mind. The interest payable is 7.1 % per annum which is compounded yearly.

The minimum deposit in a PPF account in one Financial Year is Rs. 500 and the maximum amount that can be deposited in one Financial Year is Rs. 1.50 lakh. Deposit in PPF account is eligible for tax deduction under Section 80C of Income Tax Act, 1961.

The interest is calculated for one calendar month on the lowest balance in the account between the fifth and the last date of the month. Interest is credited to the account at the end of each financial year. Such interest is free from Income Tax.

PPF account matures after 15 Financial Years excluding the Financial Year in which the account was opened. Considering the long period of maturity, facility of withdrawal is also available. A PPF account holder can take 1 withdrawal during a Financial Year after 5 years excluding the Financial Year in which the account was opened. The amount of such withdrawal is limited to 50% of balance at the credit at the end of 4th preceding year or at the end of preceding year, whichever is lower. For example, withdrawal can be taken in 2022-23, up to 50% of balance as on 31.03.2019 or 31.03.2022, whichever is lower.

IN-TEXT QUESTIONS

1. PPF account can be opened by any adult. True/False
2. The maximum amount that can be deposited in PPF account in a Financial Year is ______.
3. Interest payable on a PPF account is compounded ______.
4. PPF account matures after __ years.

1.4.7 Sukanya Samriddhi Account (SSA):

Sukanya Samriddhi Account (SSA) scheme was devised to cater to financial security of girl child. SS account may be opened by the parent/ guardian in the name of girl child below the age of 10 years.

SS account can be opened with minimum initial deposit Rs. 250. Minimum deposit to be made in one Financial Year is Rs 250/- and maximum deposit that can be made in one Financial Year is Rs. 1.50 lakh. Deposits can be made until 15 years are completed from the date of opening. All such deposits qualify for income tax deduction under Section 80C of Income Tax Act, 1961.

The current rate of interest on SS accounts is 7.6% per annum compounded yearly. Like PPF, interest is calculated for one calendar month on the lowest balance in the account between the fifth and the last date of the month.

Withdrawal may be taken from account after girl child attains age of 18 or passes 10th standard. Partial withdrawal may be taken up to 50% of balance available at the end of preceding Financial Year. SS account matures after 21 years from the date of opening of the account.

IN-TEXT QUESTIONS

1. SS account can be opened in the name of any child below 10 years of age. True/False
2 The maximum amount that can be deposited in SS account in a Financial Year is ______.
3 Interest payable on a SS account is compounded ______.
4. SS account matures after __ years from opening of the account.

1.4.8 National Savings Certificates (NSC) (VIIIth Issue):

NSC 8th issue is a savings option with 5 years maturity and investment of a lump sum at the beginning. The rate of interest is 6.8 % compounded annually but payable at maturity. At this rate, Rs 1,000/- grows to almost Rs 1,390 after 5 years.

NSC can be opened by a single adult, by up to 3 adults in case of joint account, a guardian on behalf of minor or on behalf of person of unsound mind or a minor above 10 years in his own name. Amount invested in NSC is eligible for tax exemption under Section 80C of Income Tax

Act, 1961. As opposed to physical NSC earlier, now NSC is bought in a dematerialized (paperless) form.

1.4.9 Kisan Vikas Patra (KVP):

KVP, like NSC is a long-term investment option that involves investment of a lump sum at the beginning. The rate of interest is 7 % compounded annually. At this rate, the amount invested becomes double in 10 years and 3 months.

KVP can be opened by a single adult, by up to 3 adults in case of joint account, a guardian on behalf of minor or on behalf of person of unsound mind or a minor above 10 years in his own name. Amount invested in KVP, unlike NSC is not eligible for tax exemption under Section 80C of Income Tax Act, 1961. As opposed to physical KVP earlier, now KVP is bought in a dematerialized (paperless) form.

1.5 MONEY TRANSFER SERVICES

1.5.1 Electronic Money Order (e-MO):

Electronic Money Order (eMO) is a fast money remittance service which as the word "e" indicates is carried out via internet. This service has been offered by India Post since 2008. Physical Paper-based Money Orders are no longer accepted or processed by India Post.

Parties involved in the chain of a Money Order (now known as e-MO considering physical Money Order has been discontinued by India Post) are as follows:

- **Payee**: The person who approaches Post Office with request to send money to another person.
- **Post Office**: Works as the agent of the Payee; and
- **Beneficiary**: The person to whom the Payee wants to send the money.

Money Order enables delivery of physical cash at the house or place of stay of an individual. This is an important facility for several geographies and customer groups in India. This is evident from the fact that between April 2021 and December 2021, more than 1.37 crore e-Money Orders were booked at Post offices across India. At the time of booking a Money Order at the Post Office, a unique ID for every Money Order is generated. Using this unique ID on India Post website, the progress of Money Order can be tracked. The amount for which a single money order may be issued must not exceed Rs 5,000/.

IN-TEXT QUESTIONS

1. The person who approaches Post Office with request to send money to another person is called _____
2. The maximum amount that can be sent using e-Money Order is ______.

1.5.2 Western Union Money Transfer

This service is a result of a collaboration between India Post and Western Union. This service enables receiving money from abroad called international inward money remittance to customers in India. This service is available from around 195 countries on a real time basis.

1.6 INDIA POST PAYMENTS BANK

Payments Banks are basically part-banks because they are focused on acceptance of demand deposits and provision of payments and remittance services. Payments Banks unlike usual Banks do not give loans.

India Post Payments Bank (IPPB) was launched on 1st September 2018. Since launch, IPPB has rolled out several services which are primarily offered through a combination of the IPPB mobile app and doorstep banking delivered by India Post through its Postmen and Gramin Dak Sewaks. What is unique to IPPB is that in addition to 650 physical IPPB branches, IPPB services can be accessed across more than 1,36,000 Post Offices (Access Points) and several services can be availed at the doorstep through more than 2,00,000 Postmen and Gramin Dak Sevaks equipped with smartphones and biometric devices. Services offered by IPPB include:

- Savings Account
- Current Account particularly for small merchants/ kirana stores and individual businessmen
- Digital Life Certificate (DLC) for pensioners which is also called Jeewan Praman. This is a biometric enabled digital service for pensioners who need to furnish life certificate. This facility removes the need for pensioners to physically visit offices of pension disbursing offices. With the help of Aadhaar enabled biometric authentication mechanism, a digital life certificate is generated.

- Child Enrolment Lite Client Services: These services relate to Aadhar. With the help of an android based application facilities such as child enrolment, mobile number updation and Aadhaar search are being provided by IPPB.
- IPPB linkage with Post Office Savings Accounts: With this facility, the task of transfer of money to Post Office accounts has become easy courtesy the IPPB mobile application.

Besides the above, a number of other services such as bill payments, remittance and fund transfer, Direct Benefit Transfer credit of subsidy, offering life insurance and general insurance services etc. are also being offered through IPPB.

1.7 SUMMARY

Post Office Savings Schemes offer a bouquet of beneficial options for saving. These schemes differ from each other on certain parameters including eligibility (who can invest), rate of interest (how much is the incentive for investing), income tax treatment (whether investment is eligible for tax deduction or not) and other features.

1.8 ANSWERS TO IN-TEXT QUESTIONS

1.3.5	
1	False
2	False
3	Interest
4	Maturity

1.4.1	
1	False
2	False
3	500
4	Nominee

1.4.2	
1	True
2	False
3	2
4	5

1.4.3	
1	True
2	True

1.4.4	
1	False
2	False

1.4.5	
1	False
2	False
3	Quarterly, monthly

1.4.6	
1	True
2	1.5 Lakh
3	yearly
4	15

1.4.7	
1	False
2	1.5 Lakh
3	Yearly
4	21

1.5.1	
1	Payee
2	5,000

1.9 SELF-ASSESSMENT QUESTIONS

1. Explain the different parameters of differentiation among Post Office Savings Schemes.
2. Discuss some effective options of saving for: (a) girl child; (b) senior citizen; and (c) a person requiring monthly income.
3. What are the remittance services offered by India Post?
4. What are the salient services offered by India Post Payments Banks?

1.10 REFERENCES

- Information retrieved from https://www.indiapost.gov.in/Financial/Pages/Content/Post-Office-Saving-Schemes.aspx
- India Post Annual Report 2021-22, retrieved from https://www.indiapost.gov.in/VAS/DOP_PDFFiles/AnnualReportEng2021_22.pdf

Unit-IV

LESSON-1

INSURANCE SERVICE

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STRUCTURE

1.1 LEARNING OBJECTIVES

After Reading this chapter, you will be able to:

- Develop a basic understanding of the insurance sector
- Understand the working and functioning of the Insurance Sector.

- Explain the principles, and provisions that govern the Life as well as General Insurance Contracts
- Compare the various types of life insurance policies available in the market

1.2 INTRODUCTION

When we are young, healthy, have diverse sources of income, and are living our best life possible, we generally don't think much about our uncertain future. The future, by its nature, is always uncertain. Man, being a social animal and risk-averse, always tries to mitigate the risk. Therefore, it becomes necessary for every individual to safeguard his/her future, regardless of how much money they make, how well their business is going, or how robust and healthy they are today. Sharing risk through economic cooperation is one of the most popular ways to reduce the risk that results from unknown future events, and this practice eventually gave rise to the idea of 'insurance'.

Insurance does not prevent the occurrence of uncertain events; however, it reduces the risk through the collective bearing of risk by a large number of people. Thus, it may be defined as a scheme of covering large risks of a few people among a large number of people by spreading the risks in exchange for a small, fixed amount, which is termed as *Premium*. the basic premise of 'collective bearing of risks' rests upon individuals exposed to similar risks pertaining to similar assets contribute to a common pool of funds to mitigate the individual risk by paying a small, fixed amount at regular intervals, to compensate the affected party/parties among themselves out of the common pool.

1.3 CONCEPT OF INSURANCE

In legal sense, an insurance may be defined as a contract (in a form of policy) between two parties- the insurance company (called Insurer), and an individual (called Insured), wherein the insurer promises to indemnify for financial losses, on the occurrence of particular event, due to insured in return for the premiums paid at regular intervals. The 'insurer' and 'insured' are also known as 'assurer' and 'assured' respectively.

In a nutshell, insurance is a risk transfer mechanism in which an individual transfers his or her risk to an insurance company in exchange for financial protection against unforeseen events. And the amount paid for this arrangement is known as the premium. There is insurance available for a wide range of risks, from your life to the mobile phones you use. Finally, it is critical to safeguard what is "important" to you.

The idea of insurance operates under the principle of "risk pooling." One must pay recurring payments (also known as premiums) toward the cost of the insurance when an individual purchases a specific type of insurance policy from an insurance provider for a predetermined time with a predetermined level of coverage. Similar to this, an insurance company will collect premiums from all of its customers (also known as insured) and combine the funds to pay for losses caused by an insured on the occurrence of specified event(s). If the covered event occurs and one files a claim, the insurance company will use a pool of premiums paid by policyholders to cover his/her losses. As mentioned earlier, an insurance policy is offered by the insurer for a pre-determined period of time. Therefore, some insurance will not pay back, any compensation or the premiums paid during the policy periods, if the policyholder never suffers from the loss during the policy period. To overcome this problem, insurers have introduced various kinds of insurance products which also involve savings elements into it.

Example

Ram bought a car for ₹ 20 lakhs. He purchased car insurance —third-party insurance plus comprehensive insurance with the add-on of roadside assistance and zero depreciation. Along with that, he bought health, medical, and term insurance to safeguard his future from any unforeseen emergencies. While another car buyer named Sanjay bought a new sedan and purchased car insurance- a third-party policy because it is compulsory, he thinks purchasing any other insurance policy is a waste of money. A few months later, due to some unforeseen circumstances, Ram and Sanjay met with an accident. Ram got a claim for his car damage, and the health and medical insurance companies took care of his hospitalization bills. Whereas Sanjay has to pay for almost everything from his pocket because he only has a third-party insurance policy that only covers injuries of third parties due to accidents. There are many people like Sanjay who think investment in insurance is a waste. It is crucial to have some/specific insurance products in life.

Insurance is the most effective risk management tool, allowing individuals and businesses to be protected from financial risks arising from a variety of contingencies. The emotional and psychological losses can never be replaced, but the financial losses can be reimbursed by insurance. Though there are some uncertainties in life that cannot be avoided, insurance can help you transfer the financial risk associated with them. There are numerous kinds of insurance products available in the market such as **life insurance,** health insurance, accident insurance, term insurance, retirement plan, vehicle insurance, property insurance, etc. however, these different products may be classified into two categories:

- Life insurance products
- General insurance products

Life insurance covers individuals against the risk of death. There are many different types of life insurance policies, including term, endowment, whole, money-back, and unit-linked investment plans. Numerous life insurance plans combine protection with savings, making them excellent tools for long-term savings. Whereas General insurance policies provide coverage for monetary losses caused by events other than death. General insurance policies are available in a variety of forms and cover a wide range of risks, including health, vehicle, marine, liability, travel, and commercial risks.

The main goal of any insurance policy is to provide protection and relieve the 'insured' from a substantial financial burden on the happening of future events, which may be certain or uncertain.

IN-TEXT QUESTIONS

1. Insurance helps to:
   a) prevent the occurrence of adverse events.
   b) mitigate the financial impact of adverse events.
   c) Neutralize all repercussions of unfavourable conditions.
   d) Maintain the productiveness of assets.
2. A social Device that reduces or eliminates the risk of loss of life and property is ____________________.
3. The duration of an insurance policy's coverage is known as the
   a) Policy term b) Policy loan
   c) Policy mode d) None

1.4 PRINCIPLES OF INSURANCE

The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance. To ensure the proper functioning of an insurance contract, both the insurer (Insurance Company) and the insured (policyholder) must adhere to the seven insurance principles listed below:

1.4.1 Principle of 'ubberima fides or Principle of utmost good faith

This principle states that both parties in an insurance contract must act in good faith toward each other, which means they must provide clear and concise information about the contract's terms and conditions. In other words, the insured must provide all the relevant information about the subject matter, whereas the insurer must provide precise contract details. This principle signifies full disclosure or maximum truth to each party from each other. The absence of this principle makes the insurance contract voidable.

This principle is applicable in both types of insurance i.e., Life insurance as well as General Insurance

Example

Mr. X took a health insurance policy. At the time of taking insurance, he (insured) concealed the fact of his smoking habit and failed to disclose this fact to the insurer. Later, he got cancer. In such a situation, the Insurance company will not be liable to indemnify to Mr. X on the ground of concealed material fact

1.4.2 Principle of Proximate Cause

The doctrine of proximate cause is based on the cause-and-effect principle, which states that once the effect has been proven and the cause has been traced, it is not necessary to go any further, i.e., cause of the cause. In other words, the nearest and primary cause of the loss, or the proximate cause, should be taken into account when determining the claim for a loss.

Though it is a vital factor in all types of insurance, this principle is not used in Life insurance.

Example

A surveyor surveying a factory damaged in a fire concluded after a thorough investigation that the fire was caused by negligence as well as defective design and that both of these causes played a role in the damage. The insurance policy covered negligence, but not defective design, so the claim was denied.

1.4.3 Principle of Insurable Interest

According to this principle, the insured person must have an insurable interest in the subject matter (life or property). The term "insurable interest" refers to a subject that, if a specific event occurs, significantly alters the insured's position; but, if the specific event does not occur, the insured stays in the same position. An individual cannot buy a life insurance policy for a person on whom he/she has no insurable interest. However, in case of spouses, no proof of insurable interest is required.

It is worth to note that in order to claim the insurance amount, the insured must be the owner of the subject matter both at the time of contracting and at the time of the accident.

Example

An owner of a bookstore sells his/her book in cartons, has an insurable interest in the cartons because he is generating revenue from it. However, if he sells the cartons only, he will no longer have an insurable interest in the things available in the cartons.

Mr. X takes a life insurance policy for his neighbour. In this case, Mr. X will not get any claim from the insurer, on the death of his neighbour as he has no insurable interest.

1.4.4 Principle of Subrogation

This principle states that, following the settlement of claims for losses incurred on the insured subject matter, the insurer has the authority to act in place of the policyholder. In essence, the insurer, or firm, receives ownership rights to the insured property. This principle gives the insurer the right to recover any loss payments paid to the insured from a negligent third party, and thus, prevents the insured from collecting twice for the loss.

Example

If the goods kept in the factory of the insured gets destroyed by fire, due to negligence of the electric company (third party). The insurance company (insurer) will compensate to the insured for the losses caused by the fire and may also sue the electric company to recover the amount of loss paid to the insured.

1.4.5 Principle of Indemnity

According to this principle, the insured will only be completely compensated for their actual losses. Consequently, the insured is not entitled to make a profit from the loss suffered. The indemnification principle's goal is to put the insured back in the same financial situation he was in prior to the loss happening. For general insurance, the principle of indemnification is rigidly followed, whereas it is not relevant to life insurance contracts.

Example

Mr. X took vehicle insurance for his car. A few months later, he met with an accident that caused him ₹ 14,500 as repairing charges. He claims indemnification for ₹ 15,000 (14,500 for repairing plus 500 for transportation cost). The insurance company (insurer) will indemnify only ₹ 14,500 as the loss caused due to accident is that much only.

1.4.6 Principle of Contribution

When an insured person purchases multiple insurance policies covering the same risk, the contribution principle is in effect. In other words, if a person has insurance from multiple companies, each insurer will share the loss according to the quantity of their individual coverage. One insurance company has the right to contact other insurance companies to request a comparable amount if it has made the full payment.

Example

A property worth Rs. 5 lakhs are insured for Rs. 3 lakhs with Company A and Rs. 1 lakh with Company B. In the event of property damage worth 3 lakhs, the owner can claim the full amount from Company A but not from Company B. Company A can now claim the proportional amount reimbursed from Company B.

1.4.7 Principle of Loss Minimization

According to this principle, the insurer is obligated as an owner to take the necessary steps to minimize the loss to the insured property. The principle forbids the owner from being irresponsible or negligent simply because the subject matter is insured.

Example

If a fire breaks out in your factory, you must take reasonable measures to put it out. You can't just sit back and let the fire destroy the factory because you know the insurance company will cover it.

IN-TEXT QUESTIONS

4. The main cause of loss or damage is ______________

   a) Proximate cause b) Indirect Loss

   c) Consequential loss d) All of these

5. Insurance works on the principle of:

   a) Sharing of losses b) Probabilities

   c) large numbers d) Randomness

6. The _______________principle of insurance stipulates that the insured must have an insurable interest in the life or property insured.

7. The principle of _______________ makes sure that an insured person doesn't make profit by purchasing multiple insurance from more than one company.

8. In insurance, the......... principle means utmost truthfulness.

   a) Subrogation b) Causa Proxima

   c) Insurable interest d) Uberrima fides

1.5 LIFE INSURANCE

Let's take an Example: Rajeev is a young dynamic boy and works in a construction company. His work requires him to travel different Countries/cities to inspect various construction sites. Among them most of the buildings are under construction and hence these sites can be dangerous. The nature of his work exposes him to several risk and uncertainties. Rajeev is a solo earner of his family and having a wife and two children to feed on. So, Rajeev decided to secure his future. He realized that he needs to keep his family protected in case anything happened to him. Therefore, he decided to opt for life insurance policy to secure him against uncertainty of life. He visited to an insurance company and found out that there are various types of life insurance. And finally entered into a contract after choosing a right type of life insurance he wants. The contract will ensure that insurance company will protect Rajeev by paying a sum of money in case of any unexpected event in his life. In exchange for insurance, Rajeev will make payments to insurance company. Such payment knows as Premium. The payment can be made in one go or in regular instalments. In this case, Rajeev is taking life insurance and known as assured and the company is known as the insurer.

Insurance policies provide protection against the various types of uncertainties that can occur in the life of an individual. There are various types of insurance in the market due to the presence of a large number of insurance companies. One of them is Life Insurance. Life insurance is a contract between an insurance policyholder and an insurance company (Insurer). It is a contract in which the insurer guarantees to pay a specific amount of money to the beneficiary (nominee) in exchange for a premium, upon the death of an insured person or at the end of a specified maturity period.

Our need for life insurance stems from our desire to protect our family. If you care about the needs of your family, you will surely consider insurance. Due to the Collapse of the prevalent joint family system, where generations coexisted in harmony and had sense of financial stability due to more earning members, insurance is now more vital than ever. The nuclear family has emerged as a result of the changing times. Therefore, you must also set aside some of your income for the future as well. This is a place, where insurance can assist us.

Fewer earning members, stress, pollution, increasing competitiveness, greater aspirations, etc., are some of the reasons why insurance has gained prominence and where it plays a significant role. Insurance gives both income and the sense of security. Buying insurance relieves an individual of an unnecessary financial stress. The individual is satisfied by the idea that he has a safety net.

From the starting of your life until the time you retire, insurance can meet all of your needs. It also helps your child to get quality education. Given the future uncertainty, insurance is a must. Event like Accidents, diseases, among other occurrences, can be tremendously devastating. Insurance help to cover the costs of these unavoidable event.

In addition, retirement is the phase at which every individual has nearly completed his duties and looks forward to resting and can be painful if not properly planned. Have we considered the rising cost of living and taxes? Under such conditions, will our investment yield favourable returns? Will it provide for our family after we're gone? Surely, an insurance policy will cover these and much more. Nowadays, insurance is a requirement. It gives regular income as well as additional bonus. Life insurance has come a long way since its inception as a risk-covering medium for short periods of time.

Example: Amit is 42 years old and worked in the multinational company. His wife Nisha, who is a housewife, watches after their children. They reside in a rented apartment, whose monthly rent is 15,000 rupees. Amit has taken out a loan of Rs. 2 lakhs. His average monthly income is 40,000 rupees. Amit dies in a tragic automobile accident.

What are the financial consequences of his death for his family? There may be various implications for his family's finances. Some of these include:

- Monthly Income would cease
- His spouse and children may require financial aid from other relatives.
- His wife might not have enough money to repay the Rs 2 lakh loan.
- The family may be forced to relocate to a cheaper residence.
- His widow may have to work to pay for their bills.
- His children's schooling may suffer.

This example highlights the impact of an immature and uninsured death of primary earner might have on a family. If Amit had bought life insurance, his family would not have endured such troubles in the event of his untimely demise. A simple life insurance policy may have supplied Amit's family with a lump sum that could have been invested to replace all or a portion of his income.

Categories of Life Insurance plans –

- *Pure Protection*: - A Pure Protection plan is designed to secure one’s family’s future by providing a lump sum amount, in his/her absence. Example of pure protection includes term insurance plan.
- *Protection cum Savings*: - A Protection and Saving plan is a financial tool that helps individuals to plan his/her long-term goals like purchasing a home, funding their children’s education, and more while offering the benefits of a Life Cover. Money back policy, retirement plan and unit linked insurance plan are few examples of protection cum saving plan.

History of Indian Life Insurance

The history of insurance in India can be divided into two sections that is before and after 1912. Prior to 1912, India lacked insurance regulation legislation whereas later includes the part when Life Insurance Companies Act and the Provident Fund Act were passed.

1818: Life Insurance in its contemporary form came into India. Oriental Life Insurance Company was founded by Europeans in Calcutta as the first life insurance company in India. The Bombay Mutual Life Assurance Society was founded in 1870. This was the first life insurance firm in India.

The Life Insurance Companies Act was enacted in 1912. This act of 1912 mandated that actuaries certify the premium rate tables and periodic valuation of insurance firms (one who calculates the premium). However, this Act discriminated against foreign and Indian enterprises in a number of ways and gave priority to foreign firms, putting Indian firms at a disadvantage.

The Insurance Act was passed in 1938. It was the first law to regulate both Life and Non-Life Insurance. It was intended to provide rigorous state supervision over the insurance industry.

In 1944, the pressure for the nationalization of the life insurance sector accelerated and later it was sent to legislative assembly for amendments. After a numerous effort, nationalization was finally accomplished in 1956.

On January 19, 1956, the life insurance industry in India was nationalized. 245 Indian and foreign insurance companies and provident organizations were nationalized by the central government.

The Life Insurance Corporation Act was passed by the Indian Parliament on June 19, 1956, with a capital contribution of Rs. 5 crores from the Government of India., The Life Insurance Corporation of India was established on September 1, 1956.

1.5.1 Key Characteristics of Life Insurance

- Life insurance is a legally binding contract that pays a death benefit to the policy owner (nominee) when the insured dies.
- For a life insurance policy to remain in force, the policyholder must pay a single premium upfront or pay regular premiums over the policy term.
- When the insured dies, the policy's named beneficiaries will receive the policy's life cover.

- Term life insurance policies expire after a certain number of years. Permanent life insurance policies remain active until the insured dies, or stops paying premiums, or surrenders the policy.
- A life insurance policy is only as good as the financial strength of the company that issues it. State guaranty funds may pay claims if the issuer can't.

1.5.2 Pros of Life Insurance

Life Cover	• When a policyholder passes away, a life insurance policy pays out an agreed sum as the death benefit, giving the covered family financial security. Thus, life insurance serves as a safeguard, ensuring that even in the insured's absence, the ambitions and aspirations of his or her family are not compromised
Peace of Mind	• Life insurance provides an individual with peace of mind by ensuring that the policyholder receives life coverage and that the policyholder's loved ones are financially secure in the event of the policyholder's untimely death. Life insurance also provides financial assistance during medical emergencies, reducing the stress of having to arrange funds all at once.
Tax Benefits	• Section 80C of the Income Tax Act, 1932 allows for a tax deduction for life insurance premiums. Furthermore, according to Section 10D, the sum assured received at the maturity of a life insurance plan is tax-free if the premium is up to 10% of the sum assured or the sum assured is at least 10 times the premium amount.
Critical Illness Cover	• Some life insurance policies cover critical illnesses. Critical illness coverage is sometimes included in life insurance policies, or it can be purchased separately to supplement the benefits provided by the policy. Critical illness insurance provides financial assistance upon the diagnosis of any critical illness listed by the insurance companies. This coverage also includes financial assistance for hospitalisation expenses.
Income Benefits	•Life insurance plans such as Money-Back Insurance plans provide an option to create regular income in intervals for the insured's loved ones in the event of the untimely death of the policyholder. This ensures that the insured's family member is financially independent and secure.
Loans Against Policy	•Life insurance policies allow policyholders to take out a loan against their existing insurance policy to cover any unexpected expenses. The policyholder can borrow a certain amount without affecting the benefits provided by life insurance. Loans on insurance plans are only available for certain insurance plans.

1.5.3 Principles of Life Insurance

In India, we follow four basic principles of life insurance.

- **Insurable Interest:** This principle has been put in place to protect insurance policies against any kind of misuse. It refers to the level of interest that the potential policyholder is estimated to have in the insurance policy. This interest could be in the form of a personal relationship, family bond, etc. Based on this interest level, the insurance company approves or rejects the individual's application for a policy.

- **Minimal Risk:** Any company that provides life insurance is taking on some level of risk, since they would need to pay the assured sum at some point of time. Therefore, the company would prefer to keep the level of risk as low as possible. To ensure this, the insurer might check the applicant's medical status, smoking habits, etc. In addition, they might expect the policyholder to take good care of their health.

- **Good Faith:** As mentioned earlier, a life insurance policy is essentially a contract between the insurer and the policyholder. This contract is entered into on good faith that both parties are providing accurate relevant information, without hiding anything. If any information is withheld, it could lead to serious consequences. For instance, if the insurance provider discovers that the policyholder had a pre-existing heart condition but did not divulge the fact at the time of policy purchase, they could reject the claim made by the beneficiary, following the demise of the policyholder.

- **Law of Large Numbers:** This is a key principle of life insurance, which is based on a statistical theorem that states that with larger numbers, fluctuations tend to average out. This essentially means that since life insurance is a long-term investment, the losses and gains will average out over time, minimizing the risks for the policyholder

1.5.4 Disadvantages of Life Insurance

Life insurance disadvantages include:

- Life insurance has a high cost for older persons. Age increases life insurance premiums. Age increases risk, therefore, premiums do too. So, get life insurance early to avoid exorbitant premiums. Insurance firms may have refused to cover elderly persons with illnesses.

- Calculating returns is difficult. Life insurance returns are complex and hard to forecast. Life insurance returns are based solely on market performance. Unlike PPF and other fixed deposit plans, life insurance is hard to quantify.

- Policies: There are several life insurances firms in India. Your needs determine the appropriate life insurance plan. Different insurance policies have different characteristics, which can confuse customers. Some policies are easy, some aren't. Choosing life insurance might be difficult.
- Insurance firms may not pay benefits even after the policy matures, and they have resisted paying the sum promised or death benefit to the policyholder or nominee. They'd cite hidden fees or stipulations to reduce pay-outs. So, carefully read the policy and choose a provider with a good pay-out rate. Before signing a contract, discuss the pros and cons of life insurance with our agents.
- Any market-available financial product has exclusions and hidden terms. You must find the proper clauses and life insurance policy. Most insurance don't cover suicide in the first year, and virtually all exclude drug overdose or criminal activity.

1.6 COMPARISON OF POLICIES OFFERED BY VARIOUS LIFE INSURANCE COMPANIES

There is a bundle of life insurance plans available in the market. Choosing the right type of life insurance policy is one of the most important requirements for a comfortable, hassle-free life. It purely depends on which one suits your need and requirement basis the benefits accrued or attached to a plan. There are different types of life insurance policies in India on offer to prospective policyholders.

- **Term Life Insurance or Term Plan**: Term life insurance provides a death benefit to the beneficiary only if the insured dies during the policy term. The insurance coverage terminates with no further benefit and there is no longer a basis for a pay-out or death claim if the policyholder survives to the end of the policy term. Term life insurance is the most popular type of life insurance and is widely considered to be the simplest and purest form of life insurance. The most distinctive feature of a term insurance plan is the high amount of coverage offered at extremely nominal premium rates. It is thus cheaper than other types of life insurance policies.
- **Whole Life Insurance Plan**: The Whole Life Plan is often known as a straight or regular life. As long as the premiums are paid, it remains for the duration of the insured person's lifespan. If the insured passes away, the nominee will get the aforementioned sum. The policyholder has the right to cancel or borrow against the policy at any

moment. This policy's maturity period is one hundred years. The policy will turn into a matured endowment if the insured lives past the maturity age. The death benefit under this plan is tax free.

- **Unit Linked Insurance Plan (ULIP):** Unit Linked Insurance Plan or ULIP is a type of life insurance product that offers dual benefits of investment and life insurance. Among the different types of life insurance policies available, ULIPs enjoy a high amount of popularity owing to their versatile nature. A portion of the premiums paid towards ULIPs is directed towards ensuring insurance coverage, while the rest of the premium is invested into a bouquet of investment instruments, which can include market-backed equity funds, debt funds and other securities. ULIPs are extremely flexible instruments since investors can easily switch or redirect their premiums between the different funds available. ULIPs are also touted as having an edge over other market instruments in terms of tax-saving benefits, since their proceeds are exempted from LTCG (Long Term Capital Gains).
- **Endowment Policy**: Endowment Policy is a type of life insurance policy that acts as, both, an instrument for insurance and saving. Endowment plans aim to provide maturity benefits to the life insured, in the form of a lump sum payment at the end of the policy tenure, even if a claim hasn't been made. Endowment plan is the most suitable type of life insurance for people looking to get maximum coverage alongside having a sizable savings component. They help the policyholder inculcate the habit of savings, even while providing financial security to their family.
- **Money Back Policy**: Being one of the best types of life insurance policies, a money-back policy offers policyholders a percentage of the total sum assured at periodic intervals in the form of Survival Benefits. Once the policy reaches maturity, the remaining amount of the Sum Assured is handed over to the policyholder. However, if the policyholder dies during the policy term, their dependents are given the entire Sum Assured without any deductions.
- **Retirement Plan:** A retirement plan is a type of life insurance that focuses on providing you financial stability and security post your retirement. After you retire, you lose your regular income from employment. Investing in retirement plans can help you create a stable regular income stream. If you continue to invest until retirement, the plan will help you take care of your expenses after retirement. A retirement plan requires you to invest a certain part of your income regularly during your working life. At the time you retire, the amount that you create over the years will be converted into a regular income

stream. Retirement plans also involve death benefits. Thus, if the policyholder passes away during the course of the policy, their beneficiaries will be provided with an assured sum.

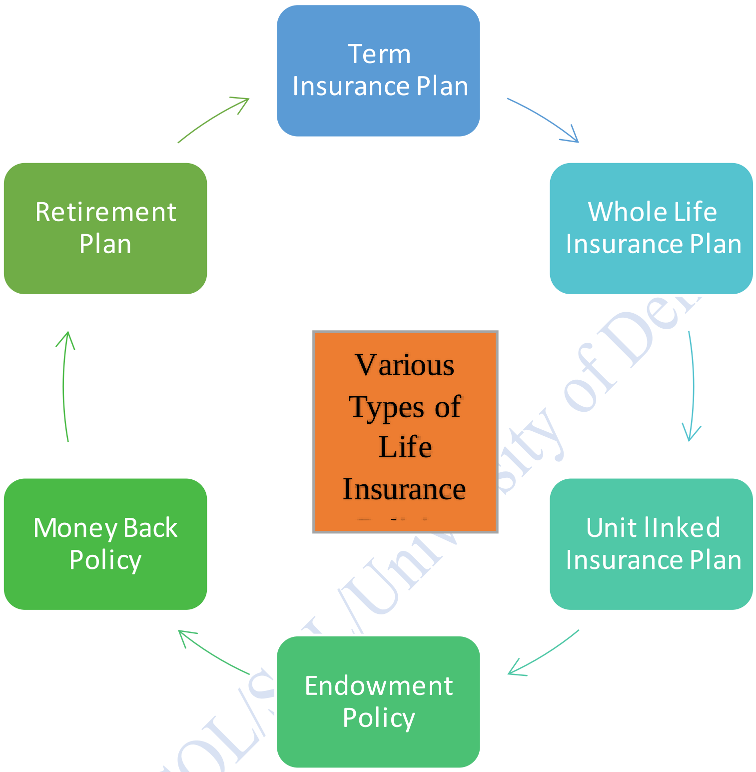

Figure 1: Various types of Life insurance Policies in India

Table 1: Comparison of Policies offered by various Life Insurance Companies

Parameter	**Term Plan**	**Whole Life Insurance Plan**	**Unit Linked Insurance Plan**	**Endowment Policy**	**Money Back Policy**	**Retirement Plan**
Description	Provide risk cover against any type of eventuality	Offer protection for life till age of 100 years	Provide benefit of investment across multiple assets class	Ensure Combined benefit of life insurance and saving	Provide periodic payments and full sum assured in case of a	Help to create retirement corpus to cover post

			with protection for life		death of policyholder	retirement costs
Term of Policy	5 to 85 years	Till 100 years	10 to 20 years	5 to 35 years	5 to 25 years	Entire Life
Death Benefit	Life Cover	Life Cover	Sum Assured	Sum Assured	Sum Assured	Regular Earring until survival
Suitability	Family Financial Security to family at reasonable cost	To Secure Family fortune	Stress free planning with assured return on the investment	High yield portfolio investment with life insurance	Periodic income and life coverage	Enables safe and secure retirement with steady income

IN-TEXT QUESTIONS

9. Which insurance policy offers both insurance and investment under a single integrated plan?

   a) Endowment Plan   b) Money Back Policy

   c) Unit Linked Insurance Plan   d) Term Insurance Plan

10. A person whose risk is covered by insurance is known as the

    a) Insured   b) Merchandiser

    c) Marketer   d) Agents

11. A nomination can be made only in favour of-

    a) Parents   c) Spouse and children

    b) Spouse   d) Any Individual

12. The major goal of life insurance is:

    a) long-term investment   c) tax benefits from savings

    b) short-term investment   d) None of them

1.7 TERM INSURANCE

Term insurance offers a coverage for a fixed period of time. If the insured dies during the policy's term, the death benefit is paid to the nominee. Term plans protect your family in case of death or uncertainty. It gives a certain level of coverage for a specific time. Since, the amount of premium is low, it allows you to insure a substantial amount. Therefore, an appropriate financial security can be provided to family without accumulating a huge wealth. The plan delivers an exceptional coverage which is not offered by any other investment plan. This coverage protects against premature death and financial consequences.

Example

Ajay is a 30-year-old, wishes to provide for his family in the unlikely event of his sudden death. He purchases a term insurance of Rs 50,00,000 for 10-year with monthly premium of 1000 Rs. The policy will pay 50,00,000 to Ajay's beneficiary if he dies within the 10-year term. If he dies after reaching the age of 40, when the policy has expired, his beneficiary will receive no benefit. If he renews the policy, the premiums will be higher than they were initially because now it will be based on his current age of 40 instead of 30. If Ajay is diagnosed with a Critical illness during the original policy term, he will be not eligible to renew the policy.

1.7.1 Types of Term Insurance

Several types of term life insurance exist. The best choice will depend on the person's circumstances.

- **Level-Premium or Level-Term Policy**: These policies provide coverage for ten to thirty years. The amount of premium and death benefit is both fixed. Due to the fact that actuaries must account for the rising cost of insurance over the policy's duration, the premium is higher than that of annually renewable term life insurance.
- **The Yearly Renewable Term Policy (YRT):** Annually renewable term (YRT) policies have no set duration and can be renewed annually without requiring proof of insurability. The insured's premiums increase from year to year as they grow. There is no defined period, but as the insured matures, the premiums may become prohibitively expensive.

- **The Policy of Decreasing Terms:** Under this scheme, the death benefit of these plans decreases annually according to a predetermined schedule. The policyholder pays a fixed, level premium throughout the policy's duration.

1.8 ENDOWMENT POLICY

Endowments combine investment, insurance, and tax savings. this scheme provides you guaranteed return and stable income after retirement. This policy is an all-rounder because it also provides life insurance. It helps you reach all your financial goals. The benefit of an endowment plan enables the customer to safeguard their family from unforeseen occurrences. Unlike term insurance, endowment policies provide maturity rewards if the covered person outlives the policy period.

1.8.1 Types of Endowment Policy

- **Full-Endowments:** This plan also called with-profit endowment plans. Under these plans, the customer will get a sum assured on the maturity. If any unusual event occurs during this time, the insurance will pay the amount to the nominee. As this policy offers some extra benefit, therefore the amount paid at the maturity is often larger than the sum assured. it also helps youth to build wealth over time.
- **Unit-Linked Endowment Plan:** this plan is suitable for the people who are risk-takers and wants big returns. Fixed-term plan premiums are used to buy investment fund units. Market performance determines fund ROI (Return on Investment). It also covers life insurance.
- **Non-Profit Endowment:** This policy pays a lump sum at maturity or to your nominee in a catastrophic (uncertain) event, whichever comes first. The compensation amount is fixed and static. This policy doesn't offer any bonuses. Therefore, these plans offer pure financial safety net to your family while you're abroad.
- **Unitized With-Profit Endowment Plans:** It combines ULIPs' earning potential with guaranteed returns to protect your money from market volatility. The capital market determines project profits. However, these plans reduce market downturns by ensuring a maturity payout. The payback is assured despite market volatility. therefore, this product ensures a risk-free, high-return investment.
- **Low-cost Endowment:** This plan demands lower premium which allow the policyholder to save for future payments. The insurance guarantees the payment of sum assured to your nominee in case of emergency. Annual Bonuses improve your

retirement benefits. The purpose is to build up a fund in a certain time and be effectively use for loan repayments or some other specific goals.

IN-TEXT QUESTIONS

13. _________ was the first Indian Insurance Company
    a) **Bombay Mutual Assurance Society Ltd.**
    b) Bombay Insurance Society Ltd.
    c) Insurance Regulatory Development Authority
    d) General Insurance Corporation
14. The ....company was the first insurance company to be set up in India to help the widows of the European community.
    a) Life insurance corporation of India.
    b) **Oriental Life Insurance Company**
    c) National insurance company
    d) Bajaj insurance
15. Compared to the premium for a Whole Life plan, the premium for an Endowment plan will be _____________ for the same age
    a) **More** c) Less
    b) The same d) Double

1.9 SUMMARY

- Insurance is an agreement between two parties—the person being insured and the company providing the insurance. The insurer agrees to help the insured with losses. In contrast, the insured pays the insurer a premium in return for the guarantee.
- The foundational principles upon which the insurer-insured contract rests are as follow: - Utmost Good Faith, Proximate Cause, Insurable Interest, Indemnity, Subrogation, Contribution and Loss Minimization
- Life insurance provides financial support to dependents following the insured's death. When the insured dies, the policy pays the recipient a "death benefit." People buy life

insurance for many reasons: to replace lost income, to fund business or partnership buy outs in the event of death, to fund retirement plans, to indemnify a loan in the event of premature death, to pay for college, to provide dependency income for the family, and to protect future insurability.

- Life insurance can be classified as follows:
  a) Term insurance: Gives life coverage for a certain period.
  b) Whole life insurance offers lifetime coverage.
  c) Endowment policy: Part of premiums go toward the death benefit; rest is invested by insurer.
  d) Money-back policy: An insured receives a percentage of the sum assured in intervals throughout the term a policy as a survival benefit.
  e) Pension plans blend insurance and investing. A percentage of the premiums goes into the insured's retirement corpus, which is paid as a lump sum or monthly payment.
  f) ULIPS - Unit Linked Insurance Plans is Like an endowment plan, where part of premiums goes toward the death benefit and rest invested in mutual fund.
- Benefits of Life insurance includes family protection, Tax saving, long term investment and peace of mind. Similarly, Life insurance can be quite costly, which is one of its greatest drawbacks. The cost of life insurance depends on factors such as age, health, and lifestyle.

1.10 GLOSSARY

- **Proposer:** It is the person who pays the premiums of the policy. For example: If you have bought the policy for yourself, then you are both the Life Assured as well as the Proposer. Similarly, if you purchase an insurance policy for a family member, then you are the proposer, and the family member is the Life Assured.
- **Nominee or Beneficiary**: It is the person you appoint at the time of buying the policy to receive the benefits of your insurance policy, in your absence.
- **Life Cover**: It is the amount that the Insurer will pay to the nominee in the case of cessation of life of the individual (insured).

- **Maturity Benefit**: For Protection + Savings policies, the Insurer (insurance company) pays a certain lump sum of money on completion of the policy term. This amount is known as the Maturity Amount.
- **Premium:** A premium is an amount that is paid to the insurer for receiving the benefits of the insurance policy. These payments can be made on a regular basis throughout the policy duration, for a limited number of years, or just once, as per the options available under the policy you choose.
- **Policy Term**: The number of years for which the Life Cover continues.
- **Sum Assured**: It is the amount the insurer agrees to pay in the case of an occurrence of event, such as death.
- **Life Assured:** It is the person who is covered under the insurance policy
- **Insurer:** The insurer is the insurance firm that sells the insurance product.

1.11 ANSWERS TO IN-TEXT QUESTIONS

1. b	9. Unit Linked Insurance Plan
2. c	10. a
3. a	11. d
4. a	12. d
5. a	13. a
6. Principle of Insurable Interest	14. b
7. Principle of Contribution	15. a
8. d	

1.12 SELF-ASSESSMENT QUESTIONS

1. Define Insurance and its Importance.
2. Explain briefly the principles of insurance with suitable examples?
3. What are the different types of life insurance policies that are available in India.

4. Explain the benefits that life insurance policies offer?
5. State the principles of Life insurance.
6. Distinguish Between Term Insurance and Endowment Policy.

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LESSON-2

INSURANCE PRODUCT

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STRUCTURE

2.1 LEARNING OBJECTIVES

After Reading this chapter, you will be able to:

- Develop a basic understanding of various kinds of life insurance as well as general insurance

- Understand the relevant factors of health insurance and property insurance on one hand and life insurance on the other
- Understand Postal Life Insurance and Rural Postal Life Insurance

2.2 INTRODUCTION

Daily, we hear about accidents and misfortunes. Some of them are:

- People fall ill suddenly
- Motor cars are stolen, and individuals die or are hurt in car accidents.
- House and belongings are destroyed by fire.
- Large-scale deaths and property damage from cyclones and tsunamis.

Life is full of Uncertainties. Protecting oneself, one's family, and society against unpredictable events has been a concern for millennia.

Fortunately, there is something called "Insurance." It enables us to minimize the financial consequences of various risks and to financially protect ourselves. Despite the notion that an incident such as a death or a fire can led a devastating economic blow to someone, when we consider the society as a whole, in any given year, only a handful of individuals would suffer in such manner. If a little contribution is gathered from each member of the community and pooled to create a common fund, the pooled sum can be used to compensate the few people who have suffered the loss.

Thus, insurance is a financial instrument designed to lessen the financial impact of unforeseen disasters and provide financial security. Everyone who want to protect himself from financial distress should think of buying the insurance.

There is insurance available for a variety of items, ranging from art to pets, and one should get insurance based on their requirements and priorities. Some of them are discussed below

2.3 HEALTH INSURANCE

2.3.1 Meaning

No one anticipates becoming ill or injured, but a major disease can strike at any time. The expense of treating the disease might place a significant burden on your savings. This means that you may have to choose between providing your child with an excellent education and making your mortgage payments. Today, the expense of medical care is steadily increasing.

For example, a few cancer-related drugs cost around 50,000 rupees per bottle. Depending on their weight, patients typically require 17 to 19 bottles each year for therapy. The medication alone costs between Rs. 18 and Rs. 20 lakhs. With the addition of hospitalisation bills, medical consultation fees, chemotherapy expenditures, etc., your total expenses could surpass Rs. 25 lakhs. These costs, which are already quite high, increase annually. Most thoughtful people have taken measures to safeguard their health as soon as possible. Health insurance is a living benefit that provides funds in times of urgent need.

In this light, lets understand, what is Health Insurance?

Health insurance is a type of insurance coverage that allows an insured to receive reimbursement for medical and surgical expenses. Health insurance is an agreement in which an insurance company agrees to guarantee compensation for medical expenses if the insured becomes ill or is injured in an accident that requires hospitalisation. In general, insurance companies have agreements with leading hospitals to provide cashless treatment to their customers. If the insurance company has no affiliation with the hospital, they reimburse the insured's expenses. The government also encourages health insurance by providing a tax break.

With the rising cost of health care and medical bills that the average person cannot afford, this type of insurance has a growing market. It is estimated that a family spends 10% of their monthly income on health care. In India, where there is no public social insurance, individuals must care for themselves as well as their families. A prolonged illness or disability can devastate the family budget. Despite the fact that health insurance is an important social security financial product, it is unfortunate that in India, health insurance policies are predominantly purchased by families and individuals who can afford to pay their medical bills. However, the Indian government is making every effort to get individuals to purchase health insurance, and specialized insurance companies are promoted which are exclusively dealing in health insurance. Life insurance companies are also permitted to issue health insurance policies. A health insurance policy covers medical expenses incurred as a result of an accident, illness, or injury. Individuals can obtain such a policy in exchange for monthly or annual premium payments for a set period of time. During this time, if an insured is in an accident or is diagnosed with a serious illness, the insurance provider will cover the costs of treatment. Insured can also enjoy several add-on benefits, extended with health insurance policies, which are discussed in detail in the following sections.

2.3.2 Need for Health Insurance

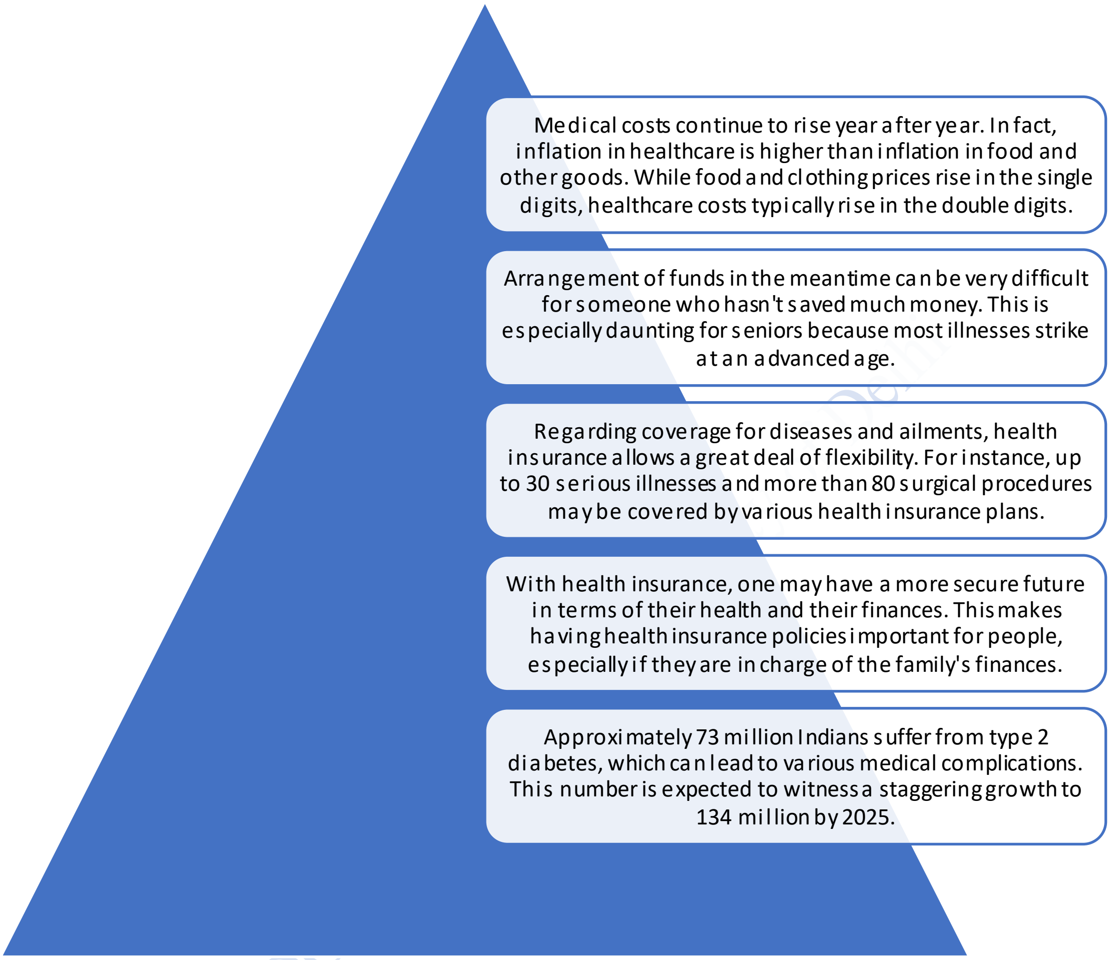

Figure1: Need for Health Insurance

2.3.3 Benefits of Health Insurance Plans

- **Hospitalisation Expenses**: Any illness that necessitates immediate hospitalisation is covered by most health insurance plans. However, claims are only accepted if the illness hasn't already been identified when the insurance plan wasn't used.
- **Pre and Post Hospitalisation Charges**: A health insurance plan may pay for pre-hospitalization costs such as diagnostic costs, physician fees, etc. The majority of insurance carriers also pay for post-release expenses including prescription drugs,

regular check-ups, injections, etc. It is possible to recover compensation cash in the form of a lump sum or by generating the requisite bills.

- **Lifetime Renewability**: The insurance providers of health insurance policies are required by the Insurance Regulatory and Development Authority of India (IRDA) to provide lifetime renewability benefits to the policyholders. It enables you to renew your health insurance plan without any upper age limit restrictions. Parents and senior adults will benefit the most from this feature because they can renew their insurance without getting stressed to seek additional health insurance coverage as they get older.

- **Cashless Treatment**: Every health insurance provider develops a network of hospitals where the insured can make cashless claims. This simplifies the entire process of receiving emergency medical care. Individuals are not required to pay for any of the covered treatments at a network hospital.

- **No Claim Bonus**: Insured people receive discounts, or a bigger amount insured (at no additional cost) in the following years for each year without a claim, which can help lower their yearly premium payments or extend their sum insured coverage.

- **No Room Rent Capping**: Room rent of hospital rooms is covered under such health insurance policy, allowing insured individuals to recover with comfort. Total amount disbursed in such cases are specified by an insurance company beforehand.

- **Medical Check-up**: Options for health examinations are also provided by insurance policies. Some insurers may also provide free health assessments depending on insured's prior No Claim Bonuses.

- **Tax Benefit:** Section 80D of the Income Tax Act allows for the tax deduction of health insurance premium payments. You can deduct up to INR 25,000 per year from your taxable income for an insurance policy covering you, your spouse, your children, and your parents under the age of 60 years. You could claim an additional INR 50,000 deduction if you also acquired a policy for a parent over the age of 60 years.

- **Transportation Charges:** Any ambulance expenses incurred during a medical emergency are covered by a standard health insurance policy. This is a significant benefit because premium hospitals frequently charge exorbitant transportation fees.

2.3.4 Comparison of Policies offered by various Health Insurance Companies

In India, there are seven different types of health insurance plans to meet the various needs of people. These are explained further below:

- **Individual Health Insurance**: Individual health insurance plans have a single policyholder who receives all of the coverage benefits available. Individual health insurance plans typically cover insureds' medical expenses based on the sum insured chosen and the premium paid. Some of the benefits provided by these plans include in-patient hospitalisation expenses, pre-hospitalization and post-hospitalization expenses, day-care expenses, and domestic hospitalisation expenses. It typically comes with no upper age limit for policy renewal, implying that the plan provides the insured with lifetime renewability benefits. There are no limits to the number of claims that can be made during the term of an individual health insurance policy.
- **Family Floater Health Insurance**: A family floater health insurance plan covers the entire family for a floater sum insured. Family floaters are advantageous because they make it easier for an individual to manage his or her health insurance by covering himself or herself as well as family members. This insurance plan offers an affordable option when one has to include his/her parents in the policy as compared to a separate senior citizen health insurance policy for their parents.
- **Senior Citizen Health Insurance**: Senior citizen health insurance plans are designed to meet the insurance needs of people aged 60 to 75. It is advisable to obtain a senior citizen health insurance policy because most individual or family floater health insurance plans do not cover people over the age of 65 and only allow renewals. Some of the coverage benefits of senior citizen health insurance plans include day-care expenses, cashless hospitalisation, domiciliary hospitalisation expenses, coverage for pre-existing diseases, and coverage for specific diseases.
- **Women-Specific Health Insurance Plans**: Women-specific health insurance plans are specifically designed to meet the insurance needs of women of various ages. These plans protect women from healthcare costs during pregnancy, retirement, coverage for new-born babies, coverage for child education, and so on. Furthermore, after a certain age, they cover women for specific diseases to which they are predisposed. These plans have low premiums and generally provide the insured with lifetime renewability benefits.
- **Critical Illness Insurance Plans:** Plans for critical illness insurance cover a variety of life-threatening conditions, including heart attack, stroke, paralysis, cancer, renal failure, etc. When a critical disease is initially diagnosed, these plans offer a lump payment that the insured person may use both inside and outside of India. The insured may even use this money to pay off any outstanding bills, such as those for a child's

education, or in any other manner permitted by the requirements. Given the high cost of critical illness treatments, it is advised to be protected by such insurance.

- **Disease-Specific Health Plans:** People looking for comprehensive coverage for a specific disease, such as cancer, diabetes, or heart disease, may be interested in disease-specific health insurance plans. This plan is also available to those who have a corporate health insurance plan or any other regular health insurance plan, as these plans may not always provide adequate coverage for specific diseases. Disease-specific health insurance plans waive the waiting period, which is otherwise required if you are covered under a standard health insurance plan. The plan, however, is best suited for people who have a family history of a specific disease, such as hypertension or diabetes.
- **Top-Up Health Insurance:** A top-up health insurance plan enables the insured to enhance the sum insured under their base policy to make up the difference in case hospital costs are higher than the plan's limits. When a single hospitalisation occurs during the term of the base health insurance policy and the amount of the claim exceeds the deductible and the total insured, the top-up health insurance policy kicks in. These plans handle each claim independently.

Table 1: **Comparison of Policies offered by various Health Insurance Companies**

Health Policy	Description
Family Floater Health Plan	Cover all family member (you, your spouse, children and parents) in a single policy
Critical Illness Health Plan	Provide financial coverage to insured in case he/she diagnosed with listed critical illness
Top up Health Plan	Provide Extra Coverage in case your existing plan is not sufficient to cover the medical bills
Senior Citizen Health plan	Provide quality healthcare treatment such as domiciliary hospitalization and psychiatric care to the people above the age of 60 years.
Individuals' health Plan	Provide coverage only to an individual. It covers expenses like hospitalization for injuries, illness, Surgery Cost, room rent, day-care etc.
Personal Accident Assurance	Cover the medical expenses that occur due to an accident while providing coverage for partial disability, permanent disability and accidental death.

IN-TEXT QUESTIONS

1. Which of the following terms matches closest with 'Family Floater'?
   a) Health insurance   c) Property insurance
   b) Accidental injury   d) Consequential loss
2. Health Insurance coming under ....Insurance
3. A health insurance should be
   a) Affordable   b) Continuous
   c) Universal   d) All of those
4. ________ is a form of health insurance against loss by accidental bodily injury
   a) Property insurance   b) Marine insurance
   c) Personal insurance   d) Accident insurance
5. ______is a plan that is tailor made for families.
   a) Floater Health Insurance Policy   b) Group health insurance
   b) Unit-linked   d) Health insurance

2.4 PROPERTY INSURANCE

2.4.1 Meaning

The Property insurance policy protects the physical goods and equipment of a business or home against losses caused by theft, fire, and other perils. It could be an all-risk policy that protects against all of the risks specified in the policy document. Property insurance is a package policy that provides a variety of coverages under a single policy. They may also cover personal liabilities in some cases.

Further, property insurance coverage also covers the risk of all damage caused by fire, theft, wind, smoke, lightning, etc., but it excludes damage caused by water owing to flooding, water seepage, tsunamis, cyclones, etc. Some property insurance policies also don't cover losses caused by terrorism, earthquakes, and other war-related events.

2.4.2 Cost Covered under the Property Insurance

There are three types of property insurance coverage which are explained below:

- **Replacement cost:** The expense of repairing or replacing property that is of equal or greater value is covered by replacement cost. Instead of using the cash value of the assets, the coverage is based on replacement cost values.
- **Actual cash value:** It signifies the payment of replacement cost *minus* depreciation to the insured. For instance, if a property that is five years old is destroyed, the insured will receive the value of the five-year-old property rather than the new one.

2.4.3 Types of Property Insurance

Property insurance compensates the property owner financially in the event that his or her property and its contents are damaged. Depending on the type of property and risks covered, property insurance policies can be classified into various categories. Here are some common types of property insurance available in India:

- **Homeowner's Insurance**: In India, this is the most common and widely purchased type of property insurance. As the name implies, homeowner's insurance protects the owner's property from financial losses caused due to expected perils. In fact, many lenders have made homeowner's insurance mandatory for those seeking to finance their house.
- **Renter's Insurance**: Similar coverage is offered by renter's or tenant's insurance and homeowner's insurance. However, this specific sort of property insurance is only intended to protect the tenant's personal items kept inside the rented home. It could consist of things like clothing, jewellery, furniture, electronic devices, etc. Some policies also cover additional liabilities a tenant may incur towards his/her landlord.
- **Fire Insurance**: One of the most frequent accidents that can seriously harm a property's contents and surroundings is an accidental fire. A unique kind of property insurance called fire insurance offers protection against such inevitable fires and related risks including explosion, implosion, lightning, impact damage, etc. Both residential and commercial properties can get a fire insurance policy.
- **Commercial Property Insurance**: This kind of fire insurance is also highly popular in India. Commercial properties like offices, warehouses, retail stores, eateries, and factories are covered by this sort of property insurance. It is prudent for business owners to obtain commercial property insurance to protect their operating capital in the event that their commercial property and its contents are compromised.

- **Natural Disaster Insurance**: A standard property insurance policy may or may not cover natural disasters. However, perils such as earthquakes, hurricanes, storms, floods, cyclones, etc. have the potential to completely destroy a property, resulting in huge financial losses for the owner. A special type of property insurance, known as natural disaster insurance, secures a property against such perils.

IN-TEXT QUESTIONS

6. Property Insurance may not include ___________

   a) Burglary b) Fidelity

   c) Insolvency d) Sickness

7. Risk is the chance of ___________

   a) Peril b) accident

   c) loss d) event.

8. The person who seeks protection against a risk and to whom the insurance policy is issued is known as ___________

   a) insurer b) customer

   c) insured d) creditor

9. When a particular property is insured with two insurers it is called ________

   a) Property insurance b) Double insurance

   c) Single insurance d) Particular insurance

2.5 POSTAL LIFE INSURANCE

2.5.1 Meaning

The Postal Life Insurance Scheme provides high returns on premium with life insurance coverage. This scheme offers a maximum sum assured of Rs. 50 lakhs. The Government of India offers this policy to employees of Central and State Public Sector Enterprises, Central and State Governments, Government Aided Educational Institutions, Universities, Government Aided Educational Institutions, Autonomous Bodies, Local Bodies, Cooperative Societies, Joint Ventures with at least a 10% Government/ PSU stake, etc.

Postal Life Insurance (PLI), the oldest insurer in the country, was established on February 1, 1884. The program was originally intended as a welfare program for Postal service employees. and later extended to the employee of Telegraph department employees in 1884. Initially, the maximum insurance limit was Rs. 4,000, whereas it is currently Rs. 50 lakhs. Postal Life Insurance is among the earliest insurance schemes to be launched in India. The most remarkable aspect of a PLI scheme is that it yields high returns (with bonus) for policyholders while charging extremely low premiums.

2.5.2 Characteristics of Postal Life Insurance:

A policyholder is entitled for the following advantages:

- **Nomination facility**: The policyholder is able to choose a beneficiary and can alter his/her beneficiary
- **Loan facility**: This policy comes with a loan facility. The policyholder may pledge his or her policy as collateral to the Heads of the Region/Circle on behalf of the President of India once the policy has reached maturity for three years in the case of an Endowment Assurance policy and for four years in the case of a Whole Life Insurance policy. In addition, this programme provides assignment options.
- **Policy Renewal**: A lapsed policy can be renewed by the policyholder. The policy can be revived if the following conditions are met:
  1. The Policy has lapsed after six consecutive non-payments of premium with the policy being in effect for less than three years.
  2. The policy has lapsed after 12 consecutive premium non-payments, if it has been in effect for more than three years.
- **Duplicate Policy Document**: If the policyholder loses the original policy document, a duplicate policy document will be issued. This applies in case where original policy document has been mutilated, burned, or torn and the insured desires a duplicate.
- **Conversion of Policy**: This Whole Life Assurance policy can be converted to an Endowment Assurance policy. An Endowment Assurance Policy may be converted to another Endowment Assurance plan in accordance with the insurer's regulations and guidelines.

2.5.3 Benefits of Investing in Postal Life Insurance

The Postal Life Insurance program include the following Benefits and savings:

- The insured can avail income tax exemption as provided under Sec. 88 of the Income Tax Act.
- This policy offers assignment, loan, conversion, surrender, and paid-up value options.
- The Process of Transferring the policy to any Circle within India is free.
- Passbook facility for keeping a track of premium payments, loan transactions, etc. is available
- Annual, half-yearly, and monthly premiums payment options are available. Policyholders can make a payment on any working day when its due.
- PLI also includes incentives for advance payments. If policyholder decided to pay six months of premiums in advance, he/she can avail a discount of 1% on total amount of premium paid (total value of premium worth). Similarly, if he decided to pay a premium of 12-month in advance, in that case he/ she can avail a discount of 2% on total value of premium worth.
- This scheme has a centralised accounting which makes claims process simple, easy and rapid.

2.6 RURAL POSTAL LIFE INSURANCE

2.6.1 Introduction

In 1993, a special committee known as the Malhotra Committee observe that insurance represented a negligible proportion of India's gross household savings. The numbers of people from the rural area who holds insurance policy were notably low. As per the committee Suggestion, in rural places, postmasters have very trusting and pleasant relationships with consumers, therefore this position might be leveraged to promote insurance.

With a robust network of urban and rural post offices, Rural postal life insurance was set to succeed. It was believed that through utilising the existing network of post offices, the anticipated operational costs can pull down significantly. Presently, RPLI is the only insurer in the country that offer highest returns for the lowest premiums. RPLI provides insurance to all government sector personnel, including the military, government school staff, nationalised banks, and local civic groups. Private sector employees can also get rural postal insurance.

2.6.2 Benefits of Rural Postal Life Insurance in India:

Several benefits are associated with rural postal insurance schemes. Some of the most outstanding advantages of these schemes are listed as under.

- Nominations can be changed.
- The policy can be assigned to a lender to avail a loan.
- A Duplicate Policy Bond will be issued in case the original policy is lost.
- In case the policy has lapsed, it can be revived.
- You can convert the policy to an Endowment Assurance from a Whole Life Assurance.

2.6.3 Insurance Schemes under Rural Postal Life Insurance:

There are a variety of insurance programs available to customers under the rural postal insurance initiative. These plans consist of pure insurance plans and endowment plans. Customers may enroll in one or more of these insurance plans and may also switch plans if they are dissatisfied. Important characteristics and advantages of these programs are described in detail below.

Table 1: Various policy Under Rural Postal Life Insurance (Based on whole Life Assurance)

Bases	**Name of the Policy (Based on Whole Life Assurance)**	
	Whole Life Assurance (GARMA SURAKSHA)	**Convertible Whole Life Assurance (GRAMA SUVIDHA)**
Objective	To pay the nominee a sum equal to the assured sum plus accrued bonus in the event of the policyholder's demise.	To pay the nominee a sum equal to the assured sum plus accrued bonus in the event of the policyholder's demise.
Eligibility criteria	Minimum age to enter is 19 and maximum age to enter is 55	Minimum age to enter is 19 and maximum age to enter is 50
Conversion of Policy	Whole Life assurance policy may be converted to an endowment policy after	Whole Life Assurance can be converted to Endowment after Completing 5 years. However,

	one year of coverage has passed and before the policyholder reaches age 59.	the same can't be converted After 6 years.
Minimum Sum Assured	Rs 10000	Rs 10,000
Maximum Amount Guaranteed	Rs 100000	Rs 1,00,000
Loan Option	Yes, After Completion of four years of policy.	Yes, After Completion of four years of policy.
Surrender of policy	After completion of 3 policy years	After completion of 3 policy years; bonus in case of surrender is nullified
Premium Payable	Premiums vary by sum assured, applicant's age etc.	Premiums vary by sum assured, applicant's age etc.

Table 2: Various Policy under Rural Postal Life Insurance (Based on Endowment Policy)

Name of the Policy (Based on Endowment Policy)			
Bases	**Endowment Assurance (GRAMA SANTOSH)**	**Anticipated Endowment Assurance (GRAMA SUMANGAL):**	**GRAM PRIYA (10 Year RPLI)**
Objective	To provide the nominee/assignee/heir with the sum assured and bonuses until they reach the age of maturity on the demise of upon the policyholder.	To provide periodic benefits to policyholders. Only the sum insured, and bonuses will be paid upon the policyholder's death, and staggered payments will Cease.	To provide benefits to the policyholder or his/her nominee upon expiration of the policy term. The

			assurance covers the sum assured plus accrued bonuses.
Eligibility criteria	Minimum age to enter is 19 and maximum age to enter is 55	Minimum age to enter is 19 years and maximum age to enter is 45 years	Minimum age to enter is 19 years and maximum age to enter is 45 years
Description	This scheme is an endowment plan aimed to fulfil the insurance needs of policy holders. Loan can be availed against this policy but only after Completion of four years. Similarly, the policy can be surrender after completion of 3 years; bonus in case of surrender before 5 years is nullified	This is a money-back insurance policy, suitable for consumers who need short-term cash. This scheme offers for 2 tenures. One for 15 year and another for 20 years. For the former, benefits are paid at an interval of 6, 9, and 12 years; for the later, benefits are paid at interval of 8, 12, and 16 years.	This is an endowment plan with a 10-year term. Coverage commences on the date the policy is purchased
Minimum Sum Assured	Rs 10,000	--------	10,000
Maximum Amount Guaranteed	Rs 1,00,000	Rs 50,00,000	10,00,000

of Policies offered by various

2.7 PENSION PLAN

2.7.1 Meaning

Pension schemes offer both investment and insurance cover. By investing regularly in your pension plan, you'll accumulate a large sum over time. This will ensure steady retirement income. The PPF is a popular retirement plan in India. Early retirement contributions produce a funds to have financially stable golden future. Compounding can help a retirement plan beat inflation.

Example: Priyanka is 32 years and has an expected life of 80 years. She earns Rs.50,000 and wants to retire at age of 60. She wants Rs.30,000/month in retirement. How much should she invest to reach her goals by age 60? Priyanka needs Rs.4.05 crores to earn Rs.30,000. Assume 12% return till age 60 and 5% thereafter, with 6% inflation. She must invest Rs. 14,820 each month for 28 years to have a secure retirement.

2.7.2 Types of Pension Plan

- **National Pension Scheme (NPS)**: The Indian government created NPS to help retired people. Some of its features are as follows: Suppose, an Individual invests in this scheme till the age of 60 years. Minimum amount of investment required is Rs 1,000 per month. Your money will be placed in debt and equity funds based on your preference. Your returns depend on your selected funds. When you retire, you can withdraw 60% of your funds. You must use the remaining 40% to buy an annuity — a retirement plan offering periodic income.

- **Public Provident Fund (PPF):** The PPF is a 15-year long-term investment scheme. Therefore, the effect of compounding is tremendous, particularly toward the conclusion of the term. You can invest up to 1.5 lakh annually in your PPF account. You can either pay in full or in twelve instalments spread out over the course of the financial year. Your PPF investments are eligible for tax deductions* under Section 80C of the 1961 Income Tax Act (ITA). The government determines the quarterly PPF interest rate based on the income from government securities. The funds are not market-linked.

- **Employee Provident Fund (EPF)**: EPF is a government-sponsored savings vehicle for salaried workers. Both you and your employer must make equal contributions to your EPF account. Each month, your share is deducted from your salary. The Employees' Provident Fund Organization (EPFO) determines the rate of interest on investments. At retirement, you receive the total amount of your and your employer's contributions plus accumulated interest.

- **Annuity plans with insurance coverage**: These plans give lifelong protection and a steady income. If a tragedy event occurs while the plan is active, your family member receives a lump sum payment; however, there are other plans that do not provide financial protection. Two types of Annuity Plans exist:
  1. **Deferred Annuity**: It is a contract with an insurance company that helps you develop a fund for retirement. You have the option of making a single premium payment or paying payments on a recurring basis during the policy's term. This scheme allows you to invest in accordance with your financial resources. Your pension begins at the conclusion of the policy period. If your retirement date is many years away, this plan is appropriate for you.
  2. **Immediate annuity**: It is a contract between a person and an insurance company in which the person pays a lump sum and receives a lifelong income that is guaranteed and begins almost immediately.

2.7.3 Benefits of Pension Plan

- **Guaranteed Pension/Income**: Depending on how you invest, you can get a fixed and consistent income after retirement (delayed plan) or immediately after investing (immediate plan). This ensures financial stability at retirement.
- **Tax-Efficiency**: Certain pension plans are exempt from income tax under Section 80C. If you intend to invest in a pension plan, Chapter VI-A of the Income Tax Act of 1961 provides significant tax relief. For instance, Section 80CCD permits tax deductions for the Atal Pension Yojana (APY) and the National Pension Scheme (NPS).
- **Liquidity**: Retirement plans leads to limited liquidity. However, some plans allow withdrawals even during the accumulation phase. This will eliminate the need to rely on bank loans or other sources to meet financial needs during times of emergency.

2.8 UNIT LINKED INSURANCE PLAN

2.8.1 Meaning

A unit linked insurance plan (ULIP) is a multifaceted product that offers both insurance coverage and equity or bond investing exposure. This product requires regular premium payments from policyholders. The portion of the premiums is pooled with the assets of other policyholders and invested in stocks, bonds, or a combination of the two. A unit-linked insurance plan can be used for a variety of purposes, including as providing life insurance, creating wealth, producing retirement income, and funding the education of children and grandkids. Usually, an investor opens a ULIP to provide for their descendants. Beneficiaries would receive payments from a life insurance ULIP upon the death of the policyholder. The investment options of a unit-linked insurance plan are structured similarly to mutual funds where they combine investments with those of other investors. As a result, the assets of a ULIP are managed with the goal of achieving a specific investment objective. Investors have the option of purchasing shares in a single market linked ULIP fund or diversifying their holdings across many funds.

2.8.2 Types of ULIP's

Depending on the **category of investment units**, there are four types of ULIP:

- Equity Funds: These ULIPs generally invest in high-risk equities and company stocks. They are risky ULIP investments, but also the most rewarding. If you have a moderate to high risk tolerance and believe that fortune favors the brave, you should select one of these schemes. Here, if you win, you win big. High payoff for high risk.
- Income, fixed-interest, and bond funds: Under this scheme, your money will be placed in government securities, fixed-income securities, corporate bonds, and other medium-risk investments. This scheme provides low to medium reward.
- Cash Funds: These ULIPs invest in money market funds, cash, bank deposits, and other low-risk money market instruments. it has low-risk as well as low-reward.
- Balanced funds are the most steady and smart investment since they diversify their investments. They It invests proportionally in high-risk equities and low-risk fixed-interest products. it has High-risk with medium reward.

Based on the **investment Objectives**

- To fund your child's education: This is one of a popular reason for choosing a ULIP because it protects your children and dependents from financial difficulties in the event of death of a policy holder
- To develop a corpus of funds: Idle assets can be put to work through investment plans, and a plan that also offers life insurance cover essentially kills two birds with one stone. Instead of navigating through the depths of hell to discover the right investment at the

optimal interest rate and the optimal duration, investor typically allow insurance companies to manage their funds. Building a large corpus is a time-consuming endeavor when pursued using the conventional method of hard labor. ULIPs minimize your involvement in the management of money and allow you to take a slice of the profit pie.

ULIPs Based available for **creating wealth**:

- Life stage based vs. non-life stage based: These plans consider themselves to be your financial aid, varying your investments between different levels of risk as you age. The strategy recognizes that an individual's goals shift throughout time and that their risk tolerance is at its maximum during their youth. Equity and debt instruments will be invested in varying proportions and at varying intervals.
- Guarantee / non-guarantee: Modern ULIPs provide guaranteed additions and benefits, though these are usually very long-term. Guaranteed ULIPs shield the investor from all types of risk, however the returns are lower. Non-guaranteed ULIPs provide a variety of investment options with varied levels of risk. While they give no guarantees, they allow you to determine where and when your money is invested.
- Single premium / regular premium: Each individual's ability to pay a premium is unique. Single premium plans demand a single premium payment at the plan's commencement, whereas regular premium plans divide and stagger the premium payments over time.
- To plan for retirement: When your normal source of income ceases and you are no longer able to work, retirement corpus building ULIPs can come to your rescue. There are ULIP plans designed to provide for your future. They provide monthly payments once the plan expires.
- To meet medical or personal emergencies: Sometimes, there is unavoidable expenses. Medical emergencies, accidents, legal bills, settlement amounts, debt, etc., can cause havoc on your finances without warning. There are options that enable you to establish a nest egg and use it as a health insurance coverage. The plan permits you to access a portion of your greater maturity corpus in order to cover emergency medical expenses.

2.8.3 Unit Linked insurance Plan Vs Mutual Fund

Mutual Fund is a financial trust that pools funds from the investors and then invest them into bonds, stocks, money market instruments, etc. Mutual fund performance depends on underlying securities. the main purpose of the plan is to enhance investors' returns. Whereas ULIP is a product that combines both investment and insurance. It combines investment and life insurance in one plan. Mutual funds and ULIPs (Unit-Linked Insurance Plans) are two excellent investment vehicles for creating long-term wealth. However, both has its own pros and cons.

Parameter	ULIP	Mutual Fund
Investment	It Combines both investment and saving. You can decide what portion will be invested in market and what portion will go to life insurance.	It's a Pure Investment product. the funds generally invested either into debt or equity. The switch between insurance product and pure investment product is not possible.
Aim	Long Term Investment for future wealth creation plus it provide life insurance	Short term investment to achieve near future goals.
Tax Benefit	The Premium paid on ULIP are eligible for deduction under section 80C of IT act. The Return on ULIP is Tax free.	Depending on the holding period the capital gains on mutual funds are taxable. The short-term gain of equity funds is taxable at the rate of 15% whereas the long-term gains are taxable at the rate of 10% Similarly, the long-term gain of debt is taxable at the rate of 20% after indexation. Whereas short term capital gain is taxable according to the individual tax rate slab.
Lock In Period	Minimum five Years	No Lock in Period for Regular Mutual Funds
Risk Cover	The beneficiary is provided with the sum assured in the case of demise of policyholder.	The investment is transferred to the nominee in case of the demise of the policyholder.

IN-TEXT QUESTIONS

10. _______________are those where a part of the premium is charged for the risk cover and the rest is invested in selected mutual funds as per the choice of the investor.

    a) Mutual fund insurance b) Unit-linked insurance

    c) Double insurance d) Partial insurance

11. A policy where the policyholder makes a one-time payment of premium, is known as a _______________:

    a) Money-back policy b) Single premium policy

    c) Salary Savings Scheme policy d) Half-yearly policy

12. What is the proof of the insurance contract?

    (a) Certificate b) Policy

    (c) Receipts d) None of the above

13. The things or property insured is called _________ of the insurance

    a) Subject matter b) Insurable interest

    c) Policy d) None

14. The cause of a possible loss, such as fire windstorm theft etc. is known as ___________

    a) Peril b) Barratry

    c) both d) None

15. The term of ULIP should not be less than ________years.

2.9 SUMMARY

This lesson discusses the salient features of a broad canvas of topics related to insurance. Health insurance is a type of insurance coverage in which an insurance company agrees to guarantee compensation for medical expenses if the insured becomes ill or is injured in an accident that requires hospitalization. Property insurance protects physical goods and equipment of a business or home against losses caused by theft, fire, and other perils. Postal Life Insurance is a bouquet of life insurance policies offered by the Department of Posts for specific segments of the population namely professionals and public sector employees. Rural Postal Life Insurance is another bouquet of life insurance policies offered by the Department of Posts for rural residents. Pension plans offer a mix of insurance and investment for pension after retirement. A unit linked insurance plan (ULIP) is a product that offers both insurance coverage and equity or bond investing exposure.

2.10 GLOSSARY

- **Actuary:** Actuaries are the experts and work with an insurance company.
  they analyze data to assess risk and help insurance firms to a set price of the Insurance Product**.**
- **Burglary:** Coverage against loss as a result of forced entry into premises.
- **Insurer:** The insurer is the insurance firm that sells the insurance product.
- **Insured.** This refers to the person(s) that an insurance policy provides coverage for.
- **Death Benefit:** The 'Death Benefit' is paid to the nominee if the person whose life is assured dies during the policy term. Sum assured and death benefit are not the same. Death benefit can be sum guaranteed or even greater, including rider and/or other advantages. Term insurance has no bonus or guaranteed additions.
- **Loss:** "loss" refers to damage caused to an insured piece of property
- **Peril:** Perils are the causes of damage to your insured property that your policy protects against. Lightning, windstorms, fire are examples some of Peril.
- **Reinstatement:** The restoring of a lapsed policy to full force and effect.
- **Risk.** Risk is the possibility that a loss will occur.
- **Surrender Value**: If the policyholder terminates the plan before maturity, the insurance company pays the amount to the person is called Surrender Value.
- **Tax Benefit:** All payments paid towards a life insurance plan are tax deductible under Section 80 (C) of the Income Tax Act, 1961. Maximum deduction is Rs.1.5 lakh.
- **Riders**: Riders are additional benefits that can be added to an insurance policy for a slightly higher price. Different insurers provide a number of riders for endowment policies.

2.11 ANSWERS TO IN-TEXT QUESTIONS

1. a	9. b
2. Personal	10. b
3. d	11. b
4. d	12. b
5. a	13. a
6. d	14. a
7. c	15. five
8. c	

2.12 SELF-ASSESSMENT QUESTIONS

1. Compare the Various types of health insurance plan available in India.
2. Define Postal life Insurance and its Importance.
3. "ULIP is a combination of investment and insurance products". Explain
4. Discuss the various types of Rural postal life insurance.
5. Explain the benefit of buying Pension Plan. Further Describe how EPF are different from PPF?
6. Mention the cost covered under the Property Insurance.
7. Describe how Unit linked insurance plans are different from Mutual fund investment.

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Unit-V

LESSON-1

STOCK MARKET: BASIC CONCEPTS

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STRUCTURE

1.1 LEARNING OBJECTIVES

After Reading this chapter, you will be able to:

- Develop a basic understanding regarding the National Stock indices that is SENSEX and NIFTY
- Understand the concept of Mutual Funds and its various types.
- Distinguish between Primary market and Secondary Market
- Analysis a basic conceptual difference between the three main type of issues and offering of company (IPO, FPO & OFS)
- Explain the importance of managing risk.

1.2 INTRODUCTION

Shares help us to develop long-term wealth. Despite the fact that some people view shares as a dangerous investment, studies have shown that investing in the right shares for a lengthy period of time (five to ten years) may beat inflation and be a better investment than real estate and gold.

Individuals also employ short-term techniques while investing in the stock market. Investing in the right stocks might help traders generate quick returns despite short-term volatility. Historically, stockbrokers used to conduct trades in stock around Banyan trees. However, as the number of brokers grew and the streets became congested, they decided to relocate. In 1854, they shifted to Dalal Street, where the oldest stock exchange in Asia – the Bombay Stock Exchange (BSE) – is now located. It's India's first stock exchange and has played a key role in the Indian stock markets since its inception.

The National Stock Exchange (NSE) was founded in 1993. Both the exchanges had switched from the open outcry method to an automated trading environment, with the operation of a few years. This demonstrates that the Indian stock market has a lengthy history. Investing in the stock market can seem like a maze, but once you start, you'll learn that investment basics are not complicated and based on the fundamentals of investment.

1800's
- 1854: Sotck exchange relocated to Dalal Street
- 1875: BSE was established

1900's
- 1956: BSE became the first stock exchange to be reconginzed under the Securities Contract act.
- 1993: NSE establish as Stock Exchange

2000's
- 2000: Commencement of internet trading at NSE
- 2000: Commmencement of Derivative trading at NSE
- 2001: BSE commences the derivative trading

The stock market performs the following functions:

a) Liquidity: The primary function of the stock market is to facilitate the sale and purchase of securities. The existence of a stock exchange market assures investors that their investments can be converted to cash. Additionally, the stock market permits them to convert long-term investments into short-and medium-term investments.

b) Making Room for Speculation: The stock exchange allows healthy speculation on assets to create liquidity and demand for the supply of securities. This leads to a market price that does not reflect the asset's true value.

c) Economic indicator: The stock market is a reliable indicator of economic growth. Every substantial change in the economy of a nation is mirrored in the stock market. The rise or fall in stock prices indicates whether the economy is experiencing a boom or a recession. The stock market, sometimes known as the economy's pulse or the economic mirror, reflects the economic reality of a country.

The stock market is rife with terms that we frequently hear but do not completely understand. Many terms used in the stock market, such as Sensex and Nifty, bull or bear markets, stock market crashes, etc., are often heard but are sometimes confused with financial jargon. The Sensex and Nifty are the two national stock market indices in India. Most of the time, these two phrases are used in the headlines of financial websites, business news networks, and pink magazines. A stock exchange functions as an economic barometer, reporting the fluctuations, trends, and movements that define a society's financial architecture. A robust economy invites foreign companies to invest in a nation.

1.3 SENSEX

1.3.1 Meaning

The Sensex, also known as the Sensitive Index, is a value-weighted index that consists of 30 firms with a base year of 1978–1949. It is comprised of the 30 blue-chip stocks that are indicative of the many industries that are most actively traded on the Bombay Stock Exchange. The primary factor that determined whether or not the company would be included in the index was its total market capitalisation. The index is reviewed semi-annually. As the economy changes, some of the stocks are replaced, and some new stocks from new sectors are included in the index to represent the performance of the economy properly. The Sensex is also referred to as a reflection or barometer of the economy and stock markets of India.

1.3.2 Salient features of Sensex

- The Sensex debuted in 1986. It's a It is a bellwether index that gauges India's 30 largest and financially strong firms.
- These BSE-listed companies represent India's largest and most important industries. It's India's most tracked index
- The SENSEX is calculated using INR and USD. As of August 31, 2021, the index was worth 3.71 trillion rupees. The following were the top five components of the index: Reliance Industries, HDFC Bank, Infosys, HDFC, ICICI.
- The SENSEX methodology has changed and evolved with the Indian economy. In 2003, it moved from market capitalization to free-float capitalization.
- Since the index uses the float instead of the number of outstanding shares, it excludes restricted stock. For example, stocks held by corporate executives are not included.
- Despite changes in methodology, the index's goals remain the same.
- The SENSEX is re-evaluated semi-annually.
- The S&P BSE index Committee chooses its components based on a variety of criteria, including

  1. They should be listed on BSE.
  2. They must be a large-to-mega-cap corporation.
  3. Stocks ought to be relatively liquid.
  4. Companies should generate profits from their core activities.
  5. Companies should strive to maintain a sectoral balance.

The Sensex's History

- Since January 1, 1986, the S&P BSE SENSEX has been released regularly. It is often used as a measure of the Indian stock market.
- The SENSEX started with a base value of 100 and a base year of 1978–1979 on April 1, 1979.
- This index has increased significantly after the Indian economy was liberalised in 1991. Between the early 2000s and January 2022, it rose from the 5000 to 60000, which clearly indicates that the Indian economy has been developing at the fastest possible rate.
- On July 25, 2001, a dollar linked version of the Sensex that is DOLLEX-30 was introduced by BSE

1.3.2 The Sensex: How Is It Determined?

- In order to determine the Sensex's value, it employs a free-float capitalization methodology.
- This approach is quite similar to the market-capitalization weighted method, which assigns more significance to companies with a larger share of the index's total market capitalization. This means that SENSEX places a larger emphasis on the indexes of leading firms.
- The free-float capitalization method is an alternative to the market capitalization method that solely takes into account freely tradable shares rather than restricted shares or shares held by top managers.

1.4 NIFTY INDEX

1.4.1 Meaning

The NIFTY index was released by the National Stock Exchange. NSE Fifty is an acronym for "National Stock Exchange Fifty" that was created by the NSE on April 21, 1996. The NIFTY 50 is the benchmark index of the National Stock Exchange (NSE), which features the NSE top 50 equity firms (out of a total of 2000)

1.4.2 A Brief History of NIFTY

- The acronym NIFTY is an abbreviation for "National Stock Exchange" and "fifty," both of which contribute to its meaning NS.
- This index comprises the 50 most-traded stocks on the exchange and measures the performance of the equity markets. However, there are currently 51 stocks listed on NIFTY. Therefore, NIFTY is also known as NIFTY50 and CNX NIFTY.
- The NIFTY is a widely followed stock market index. The first trade on this index occurred in 1994, while its foundations were laid in 1992.
- In India, it is owned and operated by India Index Service & Products Limited (IISL). India Index Services Limited (IISL) is an Indian company whose primary offering is an index. It also offers various financial products like index funds, index futures, options, etc.

1.4.3 How Does NIFTY Work?

- The NIFTY 50 is computed using two methodologies: the float-adjusted technique and the market capitalization approach.
- The level index shows how much all of the stocks in the index were worth on the market during a certain time period.
- The current base duration of the NIFTY index is November 3, 1995. The base capital of a stock is Rs2.06 trillion, whereas the base value is Rs1,000.
- The index value can be computed using the following formula:
  1. Market Capitalization = Price * Equity Capital.
  2. Free Float Market Capitalization = Price * Equity Capital * Investable Weight Factor
  3. Index value = Current market capitalization / (1000 * Base market capitalization)
- In order to determine how many shares are actually available for trading, an indicator called the "Investable Weight Factor" (IWF) is used. The index is computed in real-time as stock prices fluctuate frequently.
- The formula not only computes the value but also incorporates the changes in business processes. Some instances of corporate transformation include stock splits and rights issues.
- NIFTY serves as a benchmark by which Indian stock markets are judged. Frequent index checks help to ensure its stability and effectiveness.

IN-TEXT QUESTIONS

1. NIFTY and SENSEX are calculated based on ____________.

   A) Free-Float capitalisation B) Market capitalisation

   C) Authorised share capital D) Paid-up capital

2. When was NIFTY (National Stock Exchange Fifty) established?

   A) 1992 B) 1998

   C) 1996 D) 1994

IN-TEXT QUESTIONS

3. How many companies are a part of Sensex (Stock Exchange Sensitive Index)?

   A) 20 B) 30

   C) 50 D)100

4. Which of these is a function of the stock exchange?

   A) Role of an economic barometer B) Valuation of securities

   C) Encouraging investments and savings D) All of the above

5. Which of these is the regulatory body for the capital markets in India?

   A) National Bank for Agriculture and Rural Development (NABARD)

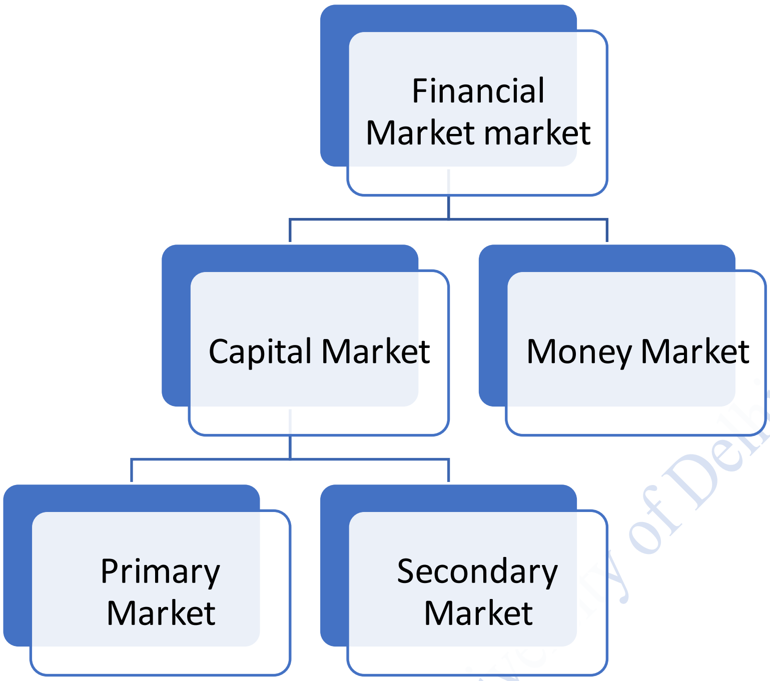
   B) Securities and Exchange Board of India (SEBI)

   C) Insurance Regulatory and Development Authority (IRDA)

   D) Reserve Bank of India (RBI)

1.5 CAPITAL MARKET: - PRIMARY AND SECONDARY MARKET

A company can raise long-term funds through the capital market. A capital market is a financial system, institution, or location where financial securities are exchanged. The capital market enables sellers or suppliers to raise capital through the sale of stocks, bonds, and other investments, which they then transfer to purchasers in need of capital. The capital market is comprised of the primary and secondary capital markets. Primary markets trade new financial securities, whereas secondary markets exchange used securities. Long-term securities are traded in the capital market. Long-term financial instruments and commodities are traded on the capital market. They possess a maturity of at least one year. Capital markets link savers and investors with wealth-creators. The funds will be used to produce long-term economic wealth. One of the key roles of the capital markets is to facilitate transactions between investors and corporations. Capital markets ease transactions for investors and enterprises. Both parties should easily discover each other and allow the legal aspect to move smoothly.



1.5.1 Primary Market

The primary market is the most essential element of the capital market. It is also referred to as the new-issue market. It deals only with new securities, or securities issued for the first time. The key role of the primary market is capital formation for various entities. It allows investors to invest their savings and surplus assets in companies launching new projects or expanding their businesses. In the primary market, companies issue new securities that have never been traded on any other exchange. It allows the government, businesses, and other institutions to raise capital through the issuance of equity and debt instruments. There are three entities involved in the primary market: the company, the underwriter, and the investors.

1. The company issues its securities for the first time.
2. The underwriter determines the price at which the newly issued securities will be sold.
3. Investors are the purchasers of new securities.

Primary market securities include notes, bills, government bonds, corporate bonds, and corporate shares.

Characteristics of the primary market

- A company should look to the primary market for its long-term capital requirements. So, the main purpose of a primary market is to meet the need for long-term capital.
- The primary market is where newly issued securities are sold. Usually, institutional investors and retail investors are the purchasers.

1.5.2 Secondary Market

On the secondary market, previously issued stocks and bonds are purchased and sold. Put another way, the secondary market is a place where investors buy and sell securities that have already been offered in the primary market. The Bombay Stock Exchange (BSE), the National Stock Exchange (NSE), and all other stock exchanges and bond markets are secondary markets. In the primary market, newly issued securities are offered to the public for the first time. Once a security is listed on an exchange, it becomes eligible for trading in the secondary market.

Characteristics of the Secondary Market

- The secondary market assists corporations in meeting their short-term liquidity needs. It increases the liquidity and marketability of existing securities.
- Additionally, it ensures honest and fair dealings to safeguard the investor's interests.

1.5.3 Primary Market Vs Secondary Market

Depending on the stage of the growth cycle, a business may need a different mix of financing. A mature business may not require long-term capital and can opt for equity financing to raise the additional capital. However, another business interested in expanding may seek to opt for a public offering. Equity funding takes place in the secondary market, whereas launching an initial public offering (IPO) operates in the primary market.

Parameter	Primary Market	Secondary Market
Meaning	A primary market is a marketplace where newly issued shares are offered to the public to meet the long-term capital requirements of the firms.	A capital market is a place where investors can buy and sell securities that have already been issued, such as debentures, shares, T-Bills, commercial papers, and so on.

	Long Term Investment for future wealth creation plus it provide life insurance	Short term investment to achieve near future goals.
Also Referred As	New Issue Market	After Issue Market
Parties of trading	Buying and selling take place between company and investors	Buying and selling take place between the investors
Financing	It provides finance to the new enterprises and existing firms to growth and expansion	It does not provide any funding to the companies.
Intermediaries	Underwriters	Brokers
Price	Prices are fixed	Prices fluctuates depending upon the demand and supply of securities.

1.6 DIFFERENT TYPES OF COMPANY ISSUES AND OFFERINGS: IPO, FPO & OFS

Suppose you want to increase your company's capital but are not receiving sufficient equity investment from private investors. Further, you do not want to borrow money from the bank or anyone else. What other alternative do you have to enhance your capital besides taking out loans? Here comes the role of an initial public offering (IPO), a follow-on public offering (FPO), and an offer for sale (OFS). Often, these terms are used interchangeably and belong to the primary market. There is a slight distinction between them.

1.6.1 Initial Public Offering (IPO)

An Initial Public Offering (IPO) is the process through which a private company goes public by issuing its shares to the general public for the first time. The corporation that offers its shares to the public is referred to as an "issuer," and it does it with the assistance of multiple investment banks. After the initial public offering is completed, the company's shares are traded on the open market. The primary idea of a private firm going public is to raise capital. By selling its shares on the open market, the company can get more money and grow its business.

What Does a Public Offering Mean for a Company?

Initially, a company receives funding from investors, venture capitalists, and a variety of corporations, and sometimes the government as well. However, when a company reaches an even larger state of expansion and its funds are exhausted, in that case company launches its IPO, goes public for the first time, and is then listed on public stock exchanges.

This implies that the company will receive the funding if an investor decides to invest in it, but this comes with a great amount of responsibility for running the business in an efficient manner. This also demonstrates great liquidity for the company and shareholders.

What Does a Public Offering Mean for Investors?

When you purchase a share or any number of shares in a company, you become a partial owner of that company. Once a company decides to go public, many options become available, including employee stock ownership plans. A company may offer stock ownership to its employees, which comes with multiple benefits, such as profit sharing. There are two types of IPO:

- Fixed Price Offering: A fixed price issue means that the corporation sets a fixed price for all of its shares and includes this information in the offer document. In this sort of IPO, all investors are informed of the price of a particular share before the firm goes public. They pay the fixed price while subscribing to a particular company's IPO.
- The Book Building Problem: In the book-building issue, the company does not have a fixed price but rather has a price band. The price is only determined when an investor's demand has been generated and recorded.

1.6.2 Follow-on Public Offer (FPO)

A Follow-on Public Offer (FPO) refers to the process through which a firm already listed on a stock market issue shares to current shareholders or new investors. The company generally undertakes an FPO in order to increase its stock base. The company employs FPO only once it has begun the IPO process to make its shares available to the public and raise finance for its business. An FPO is a subsequent issue, whereas an IPO is the initial issue. The FPO was created for two purposes:

- To minimize an organization's existing debt.
- To increase a company's capitalization

What does an FPO mean for the business?

The objective of an FPO is to raise additional capital and reduce any existing debt that the company needs to pay off. In contrast to an IPO, a company may conduct an FPO in one of two ways.

There are two types of FPO.

- Dilutive FPO: In a dilutive FPO, the corporation issues an additional number of shares, but the value of the company's shares remains unchanged. As a result, the stock price and earnings per share both falls.
- FPO Non-Dilutive: Non-Dilutive FPO indicates that the company's stockholders sell their private shares on the market. This strategy increases the number of shares available to investors without increasing the company's total number of shares.

IPO Vs FPO

Parameter	IPO	FPO
Objective	The purpose of a company's IPO is to raise capital for business expansion. As a business grows, it requires more capital to operate efficiently. Therefore, they launch an IPO to raise capital from investors.	Once the IPO is successful, it may require additional capital to expand. This is where an FPO could potentially save them. An FPO may serve dual functions. It can support a company in increasing its equity base or decreasing promoter shareholding.
Analysis Company Profile	When a company launches an initial public offering (IPO), you must review its Draft Red Herring Prospectus (DRHP) to learn more about its business prospects, financial results, and types of risk exposed. Since there isn't much information about the company, investors mostly rely on their own	Companies with a consistent track record on the stock exchange offer an FPO. Therefore, it is simple for an investor to obtain information regarding the performance of the company's stock and its track record. Additionally, you can examine the company's performance after its IPO.

	judgement and the advice of their brokers.	
Profitability and Risk	IPOs can provide investors with higher returns and be more profitable than FPOs because they give investors access to a company at an earlier stage. Therefore, they are perceived as more financially rewarding than FPOs. IPOs are riskier than FPOs.	FPOs are usually less risky than IPOs because investors can see all the information about the company. Before investing, investors also have the opportunity to evaluate a company's past performance and make assumptions about its future growth. Because they are generally launched during the stabilisation phase, FPOs are less profitable than IPOs.

1.6.3 Offer for sale (OFS)

The term "offer for sale," or "OFS," refers to selling shares of a listed company through the exchange platform. Under this method, promoter sell their shares to the general public. This method was introduced by SEBI in 2012 to facilitate the promoters of publicly traded firms to reduce their ownership and comply with the minimum public shareholding standards by June 2013. As mandated by SEBI, the mechanism was widely implemented by publicly traded corporations, both public and private. Later, the government used this strategy to sell its stake in public-sector companies.

In contrast to a follow-on public offering (FPO), where new shares are issued to raise additional capital or the sale of an existing stake by promoters, or both, an OFS mechanism is only employed when existing shares are offered for sale. Such a proposal can be made only by the company's promoters or by shareholders who own more than 10% of the company's total shares.

Only the top 200 corporations have access to the mechanism, based upon their market capitalization. A minimum of 25% of the shares offered in an OFS must be set aside for mutual funds and insurance firms. Other than these two institutional groups, no bidder is allowed to bid more than 25% of the offering size. At least 10% of the offering amount is earmarked for retail investors. A seller may offer retail investors a discount on either the bid price or the final allotment price.

The OFS window is only available for one day. The company has to tell the stock exchanges about its plans two business days before the OFS. This has a significant benefit over the follow-on public offer (FPO), which is open for three to ten days and takes a considerable amount of time to fill in the draught documents and obtain permission from Sebi. The entire retail bid amount in OFS is backed by a 100% margin. After 6 p.m. on the same day, the trading member gets back any extra money that was not allotted or was only partially allotted.

IPO Vs OFS

Parameter	**IPO**	**OFS**
Applicability	IPOs are mostly used by companies that require visibility in the listing on stock exchange platforms. Unlisted companies list themself to stock exchange through issue of IPO.	Company already listed in stock exchange can opt for OFS
Type of Share offered	Company offers share to the public for the first time.	Share of already listed firm is offered for sale.
Rule and Regulation	Company should fulfil SEBI eligibility criteria. 35 percent of the shares reserved for retail investors and a maximum investment of two lakh is allowed from retail investor.	Only top 200 companies with respect to market capitalization are eligible to OFS facility. Non-promoter shareholders holding more than 10 percent of the shares may also be eligible to sell their holdings. 25 percent of OFS shares must be reserved for insurance companies and mutual funds, and 10 percent must be reserved for retailers, per SEBI guidelines.

Process	Process involved to issue share is lengthy.	Process is small. OFS can be complete in one trading session.
Fees	No fee is required to pay by investors	Investors are required to pay charges like brokerage, security transaction tax and other charges to buy the shares

IN-TEXT QUESTIONS

6. __________ is a link between savers & borrowers, helps to establish a link between savers & Investors
   A) Marketing B) Financial market
   C) Money market D) None of these
7. Which of the following is the function of financial market?
   A) Mobilization of savings B) Price fixation
   C) Provide liquidity to financial assets D) All of the above
8. ___________ are the organisations, institutions that provide long term funds.
   A) Capital market B) Money market
   B) Primary market D) Secondary

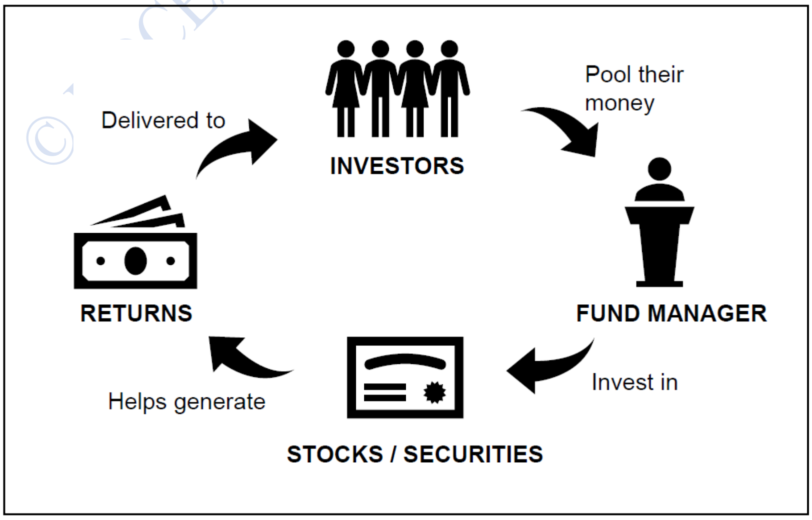
1.7 MUTUAL FUNDS

Raghav, with a family of six people, visited a fruit store. He wanted his family to be happy. Due to the diversity of ages and preferences, Raghav decides to customize a fruit basket instead of purchasing a single fruit for the family. Therefore, he brought strawberries for his wife, who was expected to create a cake that evening. He puts bananas for his elder son as he is interested in building muscles. He decided to get some apples for his daughter as she was not well. He took some pears and mangoes for his younger twins. Raghav attempted to maximize his return by diversifying his investments in a customized basket.

Similarly, a mutual fund can be viewed as an investment vehicle in which numerous individuals pool their savings and money to produce capital returns over time. A mutual fund is a pool of investors' funds that is invested in stocks, bonds, and other short-term securities. Mutual funds are an investment option for both individuals and institutions. This fund is often managed by a fund manager who charges investors a fee in exchange for overseeing their investments.

Features of Mutual Funds

- Mutual funds are a type of investment vehicle that invests in securities like stocks, bonds, money market instruments, and other assets by pooling the capital of various investors.
- Fund managers manage assets and strive to generate capital gains or income for the investors of mutual funds.
- The portfolio of a mutual fund is built and managed to meet the investment goals outlined in the prospectus.
- Mutual funds pool money from investors to buy other securities, mostly, equities and bonds.
- The value of the mutual fund firm is based on the performance of the securities it purchases. Therefore, when you purchase a unit or share of a mutual fund, you are purchasing the performance of the portfolio or, more specifically, a fraction of the portfolio's value.
- A mutual fund share indicates investments in a number of equities rather than a single holding (or other securities).
- The price of a mutual fund share is the net asset value per share (NAV per share).
- The NAV of a fund is found by dividing the total value of the securities in the portfolio by the number of shares in the fund.



- Pool saving from the investor
- Invest according to pre-specified objectives and goals
- Benefits accrue to those that contribute to this pool.
- There is thus mutuality in the contribution and the benefit.

Benefits of Mutual Funds

- Diversification: Diversification, or the mixing of investments and assets within a portfolio, is one of the benefits of investing in mutual funds. Diversification reduces risk. Buying a mutual fund is a better use of time and money than buying individual stocks.
- Simple to Use: Mutual funds are very liquid investments because they are easy to buy and sell on major stock exchanges. Also, when it comes to certain types of assets, like foreign stocks or unusual commodities, mutual funds are usually the easiest way for individual investors to invest.
- Economies of Scale: Mutual funds also provide economies of scale. When you buy one security at a time, you have to pay large transaction fees that eat up a big chunk of your investment. As mutual funds have smaller unit sizes, investors can make money through Dollar-cost averaging.
- Management Expertise: The fact that you do not have to choose stocks or manage assets is a significant advantage of mutual funds. Instead, a professional investment manager takes care of everything through rigorous research and skilful trading. So, these funds give individual investors a low-cost way to get access to money management done by experts.
- Choice and diversity of options: Investors can research and select from a diverse range of managers with varying styles and goals. Mutual funds give investors access to foreign and domestic investment possibilities

Disadvantage of Mutual Funds

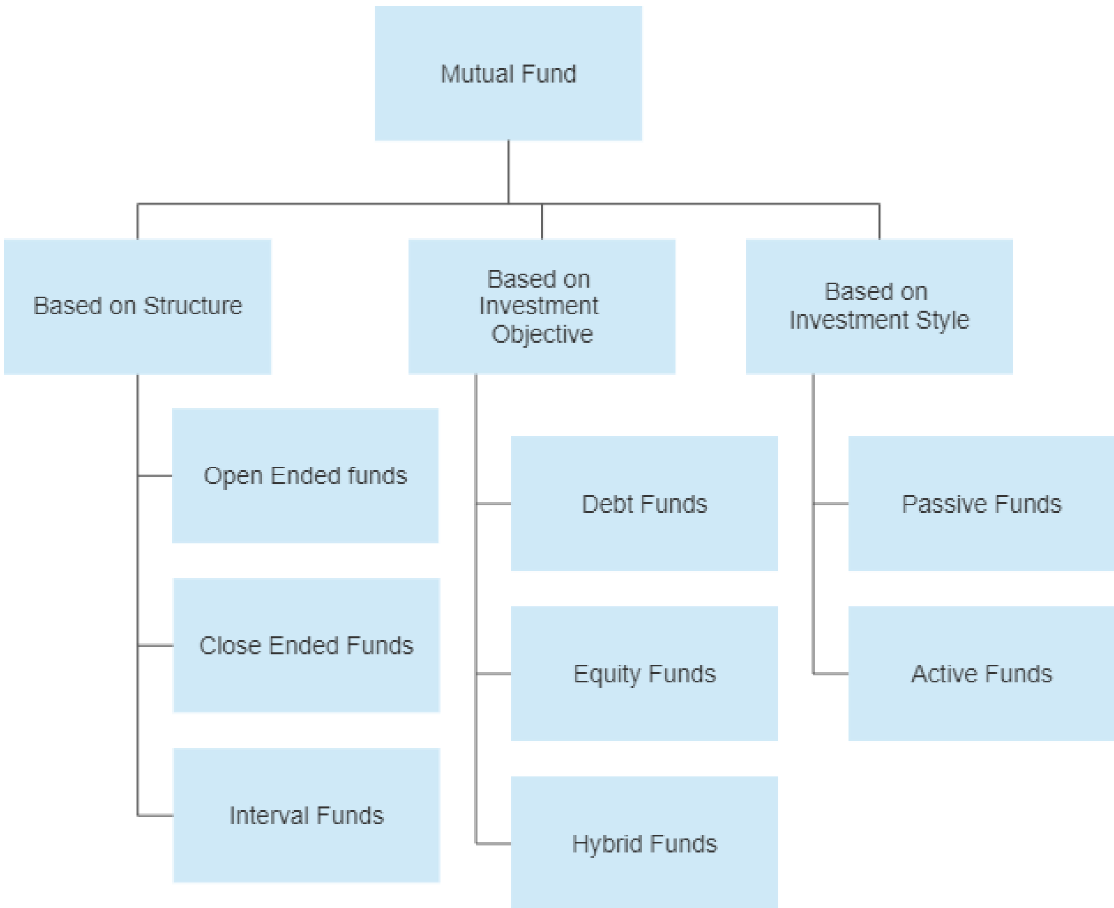
Mutual funds, like every other asset, have their flaws.

- Variance in Returns: Like many other investments that aren't guaranteed, the value of your mutual fund could go down at any time.
- Cash Drag: Mutual funds pool the funds of thousands of investors, enabling investors to invest and withdraw funds daily. In order to keep a substantial portion of their

portfolios in cash to facilitate withdrawals, fund managers are typically required to hold a large proportion of their portfolios in cash. Possessing a large amount of cash is advantageous for liquidity, but idle cash that is not earning interest is less favourable. Because cash does not earn interest, it is also often referred to as a "cash drag."

- High Costs: Mutual funds offer professional management, but it comes at a price. Investors in mutual funds have to pay these costs no matter how well the fund does, which lowers the fund's overall pay out.
- Liquidity Issues: You can request to convert your mutual fund to cash at any time, but unlike stocks, which trade throughout the day, redemptions of mutual fund shares occur only at the end of each trading day.

Different types of Mutual Fund



1. Based on the structure

   - Open-ended funds: These funds do not restrict the number or timing of purchases. Investors can enter or exit the fund at the current net asset value throughout the year. Investors seeking liquidity should invest in open-ended funds.
   - Close-ended fund: Closed-ended funds have a predetermined unit capital amount and are only available for purchase during a limited time frame. In this case, redemption is subject to the maturity date. To facilitate liquidity, however, schemes are traded on stock exchanges.
   - Interval funds: Interval mutual funds, a hybrid of open-ended and closed-end funds, permit transactions at specific intervals. When the trading window opens, investors may choose to buy or sell their units.

2. Based on the investment Objective:

   - Equity funds: Equity funds invest in company shares, and their returns depend on the performance of the stock market. These funds can generate high returns, but they are considered risky. They can be further classified according to their characteristics, such as large-cap funds, mid-cap funds, small-cap funds, focused funds, or ELSS, among others. If you have a long-term perspective and a high-risk tolerance, you should invest in equity funds.
   - Debt funds: Debt funds invest in fixed-income securities, including corporate bonds, government securities, and treasury bills. Debt funds can provide stability and a steady income with minimal risk. These plans can be broken down further into categories based on how long they last. For example, there are short-term funds, liquid funds, overnight funds, credit risk funds, and gilt funds.
   - Hybrid funds: In order to achieve a balance between debt and equity, hybrid funds invest in both debt and equity instruments. The investment ratio may be fixed or variable, depending on the fund house. The two most common types of hybrid funds are balanced and aggressive. Multiple asset allocation funds invest in at least three asset classes.

3. Based on the Investment style

   - Active Funds: In an active fund, the portfolio manager is "active" in determining whether to buy, hold, or sell the underlying securities and in selecting stocks. Active funds build and run their portfolios using a wide range of strategies and management styles.

1. The investment strategy and approach are outlined in the Scheme Information document (offer document).
2. Active funds anticipate higher returns (alpha) compared to the benchmark index.
3. The fund's risk and return will depend on the adopted strategy.
4. Active funds employ strategies to "select" the portfolio's stocks.

- Passive Funds: Passive Funds hold a portfolio that mirrors a specified index or benchmark, such as: Index Funds and Exchange Traded Funds (ETFs) In a passive fund, the fund manager has a passive role, as stock selection, buy, hold, and sell decisions are driven by the benchmark index and the fund manager needs only to replicate the same with minimal tracking error.

• Active Funds	• Passive Funds
• Rely on professional fund managers for investment management. • Aim to surpass other benchmark indexes. • Designed for investors who wish to capitalise on the alpha generation potential of fund managers.	• Investment holdings closely resemble and track a benchmark index, such as index funds and exchange traded funds (ETFs) • suitable for investors who wish to allocate precisely according to the market index. • A lower expense ratio translates to lower investor costs and improved liquidity.

IN-TEXT QUESTIONS

9. ___________ is a type of investment vehicle consisting of a portfolio of stocks, bonds, or other securities.
10. The value of one unit of investment in Mutual fund is called the ______________.
    A) Net Asset Value B) Issue value
    C) Market value D) Gross Asset value
11. The feature of a mutual fund, where it spreads the investment in varied stocks and sectors by pooling the funds of various investors, is called as ______________.
    A) Professional Management B) Affordability
    C) Diversification D) Profit
12. What are the reasons for economies of scale to the benefit of Mutual funds?
    A) Large volumes of trade B) Portfolio diversification
    C) Risk reduction D) Loss
13. Investors can enter and exit under _______ at any time
    A) Fixed maturity plan B) Open-Ended Funds
    C) Close-Ended Funds D) Interval fund
14. ____________ are funds that invest in company debentures, government bonds and other fixed-income assets.
    A) Equity Funds B) Money Market Funds
    C) Balanced or Hybrid Funds D) Debt Funds

1.8 Risk

Risk is a basic component of our lives. Taking risks or not taking risks, everything depends on our decisions. However, the greatest risk a person can take is to not take any. The relationship between risk and return in the stock market is strong. Appropriate risk management strategies reduce losses and provide traders with insight into future market trends. A trader who has made a lot of money can lose it all in one trade if they don't have a good risk management plan.

What is Risk

Investing involves making decisions about your money. Risk refers to any uncertainty in your investments that could have a negative impact on your finances. Market conditions can affect your investment value (market risk). Corporate decisions, like whether to expand or merge, can affect investment value (business risk). Events in a country can affect your overseas investment (political risk and currency risk, to name two). Other risks also exist. Liquidity risk is the difficulty of selling an investment when needed. Risk is the likelihood of a negative financial outcome that matters to you.

Types of Risk

There are two main types of risk: systematic and unsystematic.

- The term "systemic risk" refers to risks that exist throughout the system as a whole. This is the type of risk that affects the entire market or a specific subset of it. Political instability, war, and earthquakes are some examples of systematic risk. In almost all cases, protecting a portfolio against this risk is impossible. Systematic risk can't diversify. It is also known as market risk or the risk that cannot be hedged. For example, there isn't much you can do as an individual to keep the economy from entering a slowdown. This is due to the fact that the elements that create recessions and changes in the market cycle are beyond the scope of any single individual or group. That is how systematic risk operates. Individuals, on the other hand, can choose how they react to systemic risk while making investing decisions. For example, if signals indicate a recession, you should diversify your portfolio to include investments that are expected to keep their value during a slump. If you expect interest rates to rise, you may want to alter your bond holdings accordingly.
- Unsystematic risk is also known as residual risk, unique risk, and diversifiable risk. It is unique to a company or particular industry. Unsystematic risk is made up of risks that are unique to a company, like strikes and lawsuits. Diversifying can help reduce some of these risks, but not all of them. For instance, suppose that new regulatory changes are about to be implemented in the financial services sector. Companies within the industry could evaluate the potential negative effects of these developments and then create new standards, norms, or practises to mitigate these effects.

Parameter	SYSTEMATIC RISK	UNSYSTEMATIC RISK
Meaning	Risk associated with entire market or segment as a whole. Inherent in all the securities	Risk associated with specific industry, securities or company.
Controllability	Can't be managed or controlled	Can be controlled, diversified or minimised
Responsible Factors	External or macro-economic Variables like market risk, political risk, interest rate risk, purchasing power risk etc.	Internal or micro-economic variables like financial risk, Business risk and operational risk etc.
Hedging	Allocation of assets	Diversification of the portfolio.
Impact	Have an impact on the large number of securities.	Impact restricted to the securities of specific industry or company

Managing Risk

Risk in investment is unavoidable. Systematic risk and non-systematic risk can be lessened with two basic investment strategies:

- Asset Allocation: By including different asset classes in your portfolio (for example, stocks, bonds, real estate, and cash), you increase the likelihood that some investments may generate sufficient returns even if others are flat or losing value. You reduce the risk of severe losses from over-emphasizing a particular asset type.
- Diversification. Diversification is dividing the money you've allocated to a certain asset class, such as stocks, among various investment options that belong to that class. Diversification allows you to spread out your holdings.

1.9 SUMMARY

- The stock exchange is an integral part of an economy. It enables corporations to raise funds through the sale of stock, shares and corporate bonds. it enables investors to participate in the financial achievements of companies, earn profits through capital gains, and get dividends.

- A market index is an indicator of the overall performance of stock traded in stock exchange. It is further used to measure a of several factors such as market performance, price fluctuations, etc.
- The Sensex, commonly known as the S&P BSE Sensex, is one of India's oldest market indexes. It includes the top 30 companies listed for trading on the BSE.
- Nifty is the abbreviation for National Stock Exchange Fifty. Nifty is comprised of the top 50 NSE-traded firms. Similar to the Sensex, Nifty is calculated using the free-float market capitalization technique.
- Capital markets are the marketplaces where assets such as bonds, stocks, and securities are traded. The capital markets involve financial products with lock-in periods longer than one year. Capital market consist of two type of market that is primary market and secondary market.
- An IPO is a mechanism by which a private company raises fresh funds by making its shares available to investors on a stock exchange platform.
- An FPO is utilized when a listed company (that is, a corporation that is listed on a stock exchange platform) wishes to increase its capital and diversify its shares.
- Lastly, an OFS is a mechanism by which a promoter (a person who is typically the firm's founder) reduces their holding shares (i.e., this person needs money, hence he/she wishes to lower his/her stake in the company).
- A mutual fund is a form of professionally managed collective investment scheme that pool money from several investors and invest it in stocks, bonds, short-term money market instruments, and/or other securities.
- Risk is the likelihood of a negative financial outcome that matters to you. Two main types of risk are systematic and unsystematic.

1.10 GLOSSARY

- Investing: Purchasing a security with the intention of earning income, capital, or both.
- Listed Stock: A company's shares that are traded on an exchange. Issuers must pay listing fees to the exchange and follow the rules and regulations set by the exchange in order to be listed.

- Portfolio: A collection of securities owned by an individual or institution. A portfolio may include various types of securities representing different companies and industry sectors.
- Private Placement: The distribution of a security to a small group of investors in a private setting. The resale of the security is constrained.
- Prospectus: A legal document that describes securities being offered for public sale. Most of the time, prospectus documents include information about the company's operations, securities, management, and the reason for the offering.
- Risk: The likelihood or probability of future loss
- Price-Earnings Ratio (P/E) This ratio indicates how many times a stock is trading at its actual or anticipated annual earnings. it is obtained by dividing closing market price of a share with the earnings per share.

1.11 ANSWERS TO IN-TEXT QUESTIONS

1. A	9. Mutual Fund
2. C	10. A
3. B	11. C
4. D	12. C
5. B	13. B
6. B	14. D
7. D	
8. A	

1.12 SELF-ASSESSMENT QUESTIONS

1. Discuss the Various types of mutual funds are available in India.
2. Explain the function performed by the stock market.
3. Differentiate between primary market and secondary market

4. "Risk in the investment is unavoidable". In the light of this statement Explain the strategies which can be used to manage the risk.
5. Elaborate the basic difference between IPO, FPO and OFS.
6. Briefly discuss the role of stock market indices and how it is calculated.

1.13 REFERENCES

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- Information retrieved from https://www.investopedia.com/

1.14 SUGGESTED READING

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LESSON-2

STOCK MARKETS- SOME BASIC CONCEPTS (Part 2)

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STRUCTURE

2.1 LEARNING OBJECTIVES

This chapter captures broadly three areas: shares, debentures and derivatives. This chapter aims at explaining the basics of equity and preference shares, issue of bonus shares, stock split and buyback of shares, Debentures, Derivatives, Holding Period Return and other topics pertaining to stock markets.

2.2 INTRODUCTION

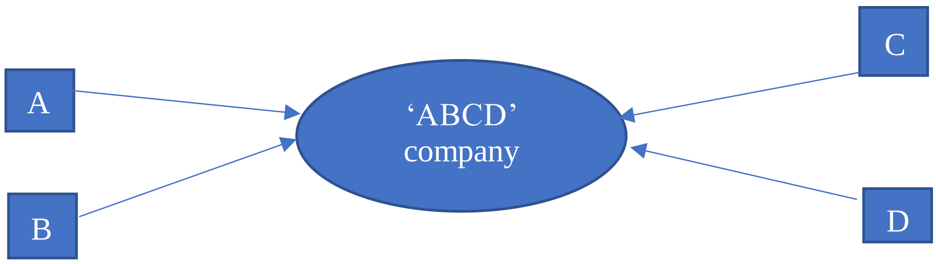
Stock markets, Debentures and Derivatives are intertwined topics with their own specifics. The increasing interest of general public in stock markets can be assessed from the fact that recently, the number of demat accounts in India crossed the figure of 10 crore. With changing demographic profile of investment age group, the willingness to invest in options other than traditional avenues of bank fixed deposits, post office deposits etc has certainly increased. The knowledge of basics of stock market can no longer be considered limited to certain domains. It is becoming more and more relevant for students of all disciplines. This knowledge has immediate application in managing one's personal finance as well.

2.3 EQUITY SHARES & PREFERENCE SHARES

In order to understand and distinguish between equity shares and preference shares, it is first necessary to understand the meaning of Share Capital. The term Share Capital is used in the context of companies. Therefore, in order to understand these terms clearly, we need to refer to the basics of the law related to companies which is contained in Companies Act, 2013. For the sake of simplicity, we will use the phrase "companies' law" for Companies Act, 2013.

As per companies' law, a company can be formed by one person (One Person Company), two or more persons (Private Company) and seven or more persons (Public Company). These persons who come together to form a company are called members and shareholders of the company depending on the context.

Illustration 5.1



In the above illustration, four persons have come together to form a company called 'ABCD'. While registering a company, the Share Capital and number of shares (called shares because these are shares of the Share Capital) into which this Share Capital is divided needs to be mentioned. You may wonder why it is necessary to mention these details about Share Capital at the time of registering a company. This is important not just for the formality of complying with companies' law but also because of a fundamental reason behind formation of any company explained in the following paragraph.

Typically, one very important reason for individuals to form a company is that the liability of company is separate from the liability of individuals and the liability of the company itself can be limited. It is in this context that Share Capital becomes important. The liability of a company's members is limited to the amount unpaid, if any, on the shares held by them.

There are 2 kinds of Share Capital as per companies' law: Equity Share Capital and Preference Share Capital. As the name indicates, the "preference" in Preference Share Capital refers to a preferential right with respect to payment of dividend and repayment in the case of a winding up or repayment of capital. This brings us to "dividend" - another crucial term often used in media coverage of stock markets which we shall cover in the next segment. No such preferential right extends to Equity Shares. Beyond this basic difference, there are few other differences between Equity Shares and Preference Shares that have been tabulated below:

Parameter of difference	**Equity Share**	**Preference Share**
Voting rights	Every shareholder holding equity shares has a right to vote on *every resolution* placed before the company. The term resolution here refers to shareholders coming together to decide issues by putting them to vote.	Every shareholder holding preference shares has a right to vote *only on* resolutions placed before the company which directly affect the rights attached to his preference shares, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital.
Redemption (exchanging something, in this case, for money or something else of value)	Equity shares cannot be redeemed	Preference shares are always redeemable. The maximum duration from issue of preference shares to redemption can (except in case of infrastructure projects) be 20 years.

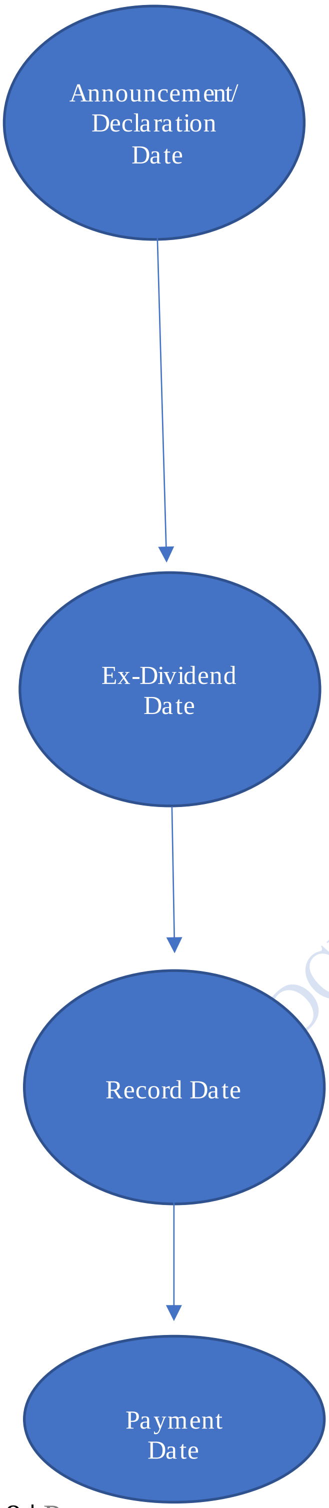
IN-TEXT QUESTIONS

1. At least 2 persons are required to form a company. True/False
2. A public company is formed by 2 or more people. True / False
3. The liability of a company's members is limited to the amount ____ on the shares held by them.
4. Preference Share Capital refers to a preferential right with respect to payment of ________.
5. Every shareholder holding preference shares has a right to vote on all resolutions placed before the company. True/False
6. Preference shares should generally be redeemed within a period of ____ years from the date of issue.

2.4 DIVIDEND

Dividends are payments made by a corporation to its shareholders from its profits. Preferred stockholders, who do not have voting rights, are typically given preference over common stockholders, who do have voting rights. In other words, A company may want to reward its shareholders by paying them a certain amount out of the profits of the company. Such an amount is called dividend.

The payment of dividend involves a chain of events from dividend declaration/ announcement date to date of payment which typically proceeds as follows:



The announcement date is the date on which the board of directors of a company announces the payment of dividend. The announcement would typically include the amount of dividend, record date and payment date.

Example: On 1st May 2022, Board of Directors of 'ABCD' company announces payment of dividend of Rs 10/- per share. The dividend will be paid on 1st July 2022 (**Payment Date**) to all those who are shareholders as on 15th June 2022 (**Record Date**).

Ex-Dividend date is 2 trading dates before the Record Date. Ex-Dividend Date is not declared by the company. The significance of ex-dividend date is that any person who wants to earn a dividend on shares (on which dividend has been declared) should buy shares before the Ex-Dividend Date. The assumption is that transfer of shares would take 2 trading days. Here, Ex-Dividend Date would be 13th June 2022.

Record Date as the name indicates is the cut-off date for deciding who is a shareholder.

Payment Date is the date of payment of Dividend.

Types of Dividends

There are numerous types of dividends a corporation can give to its stockholders. Below is a list and brief description of the most frequent forms of dividends received by shareholders. Types consist of:

1. Cash: This is the most typical form of payment and involves the direct transfer of cash from the corporation to its shareholders. Payment is typically made electronically (through wire transfer) but can also be made via check or cash.
2. Stock: Stock dividends are paid to shareholders through the issuance of new shares. These are distributed proportionally, based on the number of shares already owned by the investor.
3. Assets: A corporation is not confined to providing shareholder distributions in the form of cash or stock. Other assets, such as investment securities, physical assets, and real estate, may also be distributed by a firm, although this is not the usual practise.
4. Special: A special dividend is one issued outside of a company's standard dividend policy (i.e., quarterly, annual, etc.). It is typically the outcome of having extra cash on hand for some reason.
5. Other: Other, less usual sorts of financial assets, such as options, warrants, shares in a new spin-off firm, etc., can be distributed as dividends.

IN-TEXT QUESTIONS

7. Dividend is a certain amount out of the ____ of the company.
8. Dividend is payable to all those who are shareholders as on the ___ date.
9. The announcement of dividend typically includes the ____ of dividend.

2.5 FACE VALUE

We have discussed that while registering a company, the Share Capital and number of shares into which this Share Capital is divided needs to be mentioned. It is in this context that Face Value (also called Nominal Value) of share becomes relevant.

Face Value is nothing but the declared or stated value of each share as mentioned by the company in registration documents. Typically, the share capital of a company is stated to reveal the Face Value as well as number of shares e.g., 10,000 shares of Rs 10/- Face Value each = Share Capital of Rs 1,00,000/-.

It must be noted that shares of a listed company may trade at prices far above or below the Face Value. We will discuss this in greater detail when we discuss trading, opening price, closing price etc. For now, we only need to remember that Face Value is the formally declared value of each share, as declared by the company.

2.6 BONUS SHARES

Bonus indicates something that is over and above the usual. Bonus Shares are shares issued by a company to its existing shareholders, free of charge.

Bonus shares are issued according to the existing proportion of shares that a shareholder has in the company. Since Bonus shares are issued proportionately according to the existing proportion, the relative shareholding of shareholders does not change.

To illustrate, "A" holds 500 out of 1,500 shares of 'ABCD' company. Other shareholders in such situation would obviously hold (collectively) 1,000 shares. Now, if there is a 3 for 2 Bonus Issue, it would mean that for every 2 shares already held, a shareholder receives, 3 bonus shares. In such a situation, the before and after situation of relative shareholding would be as follows:

Before Bonus Issue	After Bonus Issue
Number of shares held by A = 500	Number of shares held by A = 500 +750 = 1,250
Number of shares held by others = 1,000	Number of shares held by others = 1,000 + 1,500 = 2,500
Ratio of A: Others = 500: 1,000 = 1:2	Ratio of A: Others = 1,250: 2,500 = 1:2

2.7 STOCK SPLIT

Stock split, as the name suggests means splitting one share into more than one shares. This will lead to reduction in the face value of a share and increase in the number of shares.

In terms of impact on the relative shareholding of shareholders, the impact of stock split is the same as issue of bonus shares i.e., it remains unaffected.

Let us understand this with the help of similar example as in the case of bonus shares. "A" holds 500 out of 1,500 shares of 'ABCD' company. Other shareholders in such situation would obviously hold (collectively) 1,000 shares. Let us assume that the Face Value of each share is Rs 30/-. Now, the company announces a 1:3 split. This would mean that a share of Face Value Rs 30/- is split into 3 shares of Face Value Rs 10/- each. In such a situation, the before and after situation of relative shareholding would be as follows:

Before Stock Split	**After Stock Split**
Number of shares held by A = 500	Number of shares held by A = 500 X 3 = 1,500
Number of shares held by others = 1,000	Number of shares held by others = 1,000 X 3 = 3,000
Ratio of A: Others = 500: 1,000 = 1:2	Ratio of A: Others = 1,500: 3,000 = 1:2

2.8 SHARE BUYBACK

Share buy-back also called share repurchase, as the name indicates is the process of a company acquiring its own shares. The company may buy shares directly from stock market or offer to buys shares from its shareholders directly at a pre-announced and fixed price.

Share buy-back leads to reduction in the number of outstanding shares. Note that this effect is in contrast to the effect of issuing bonus shares and stock split, both of which lead to an increase in the number of outstanding shares.

IN-TEXT QUESTIONS

10. ____ Value is the declared or stated value of each share.
11. Shares of a listed company may trade at prices far above or below the Face Value. True/False
12. Bonus shares are issued according to the existing proportion of shares that a shareholder has in the company. True/False
13. ___ leads to a reduction in the face value of a share.
14. The impact of stock split and issue of bonus shares on the relative shareholding of shareholders is the same. True/ False
15. Share buy-back does not lead to a reduction in the number of outstanding shares. True/False

2.9 DEBENTURE

The root of the word Debenture is the Latin word *debenture* which means "there are due". This is a clear hint that Debenture means a kind of debt arrangement. As per companies' law, debenture means any instrument (in financial sense, instrument means a document that is evidence of an agreement) of a company that is evidence of a debt.

Debenture is thus, an arrangement whereby a company raises debt from others including individuals and institutions such as banks. Like usual debt arrangement, Debenture involves payment of interest. In this case, it would be the company issuing debenture which would pay interest to a debenture-holder and at the end of the term, also pay back the principal.

Interest paid on debentures is often called coupon. There are three possibilities when it comes to coupon: one, the coupon is fixed and such debentures are called fixed coupon debentures; two, the coupon is floating or in other words can change with reference to another rate, typically the Bank Rate; and lastly, 0 coupon debentures. You may wonder why any investor would want to invest in 0 coupon debenture. To address this, companies issuing debentures would issue it at a discount. For example, a debenture with face value (which is nothing but the formal or declared value of the bond) of Rs 100/- may be sold at Rs 90/-. This means that the bond though purchased for Rs 90/- would give Rs 100/- at maturity. Although there is no recurring payment, the invested amount grows over time to a bigger amount.

Interestingly, companies' law allows companies to issue debentures with an option to convert such debentures into shares, either fully or partly, at the time of redemption. Such debentures which can be converted into shares are called Convertible Debentures and those which cannot be converted into shares are called Non-Convertible Debentures.

IN-TEXT QUESTIONS

16. In financial sense, instrument is a document that is evidence of an agreement. True/False
17. Interest paid on debentures is often called _____.
18. Debentures on which coupon keeps changing are called ____ rate debentures.
19. Zero coupon debentures are usually sold at ____ than face value of the debenture.

2.10 MARKET VALUE

We have discussed earlier that the Face Value of a share is the declared or stated value of each share as mentioned by the company in registration documents. We have also noted that shares of a listed company (a company whose shares are listed and traded on a stock exchange) may trade at prices far above or below the Face Value. In the table below, the Face Value of each share of certain well-known companies and the Market Value of each share of such companies as on 1st April 2022 on National Stock Exchange have been mentioned:

Sl No	Name of the company	Face Value of 1 share (in INR)	Market value of 1 share (In INR, rounded off to the nearest rupee) on 1st April, 2022
1	Reliance Industries Limited	10/-	2,656/-
2	Tata Consultancy Services Ltd.	1/-	3,759/-
3	HDFC Bank Ltd.	1/-	1,506/-
4	ICICI Bank Ltd.	2/-	736/-
5	Hindustan Unilever Ltd.	1/-	2,078/-

Thus, Market Value of a share is simply the value at which the share was last traded on stock exchange. Market value of a company (as a whole) is also called market capitalization which we will discuss in the next segment.

IN-TEXT QUESTIONS

20. Market Value of a share depends on the Face Value of the share. True/ False
21. Market Value of a company as a whole is called market ________

2.11 MARKET CAPITALISATION

Market Value of the company as a whole is called Market Capitalization. Market capitalization is the aggregate value of the company based on its current share price (on a stock exchange) and the total number of outstanding shares on a stock exchange. With this, we can calculate the market capitalization of any company by multiplying the current market price of the company's share with the total outstanding shares of the company.

We had considered the difference between Face Value and Market Value of 5 companies in the previous segment on Market Value. Let us see the Market Capitalization of top 5 companies by Market Capitalization on National Stock Exchange, as on 11th October 2022:

Sl No	Name of the company	Market Capitalization (In crores of INR)
1	Reliance Industries Limited	1,595,303.15
2	Tata Consultancy Services Ltd.	1,123,164.11
3	HDFC Bank Ltd.	7,80,156.31
4	ICICI Bank Ltd.	6,06,665.92
5	Hindustan Unilever Ltd.	5,99,298.50

IN-TEXT QUESTIONS

22. Market Capitalization of a company depends on the Face Value of the share. True/ False
23. Market Capitalization of a company depends on the Market Value of its share. True/ False
24. Market Capitalization of a company depends on the number of outstanding shares. True/ False

2.12 DEMAT ACCOUNT & TRADING ACCOUNT

'Demat' is the shortened form of 'dematerialization' which is the process by which physical certificates (share certificates, mutual fund certificates etc.) of an investor are converted to electronic form.

Just as a bank account holds funds in an account, a demat account holds securities in electronic form. Demat accounts began being offered in the year 1996 in India. Once stocks are held in dematerialized form in demat accounts, there is less and less need for holding physical certificates and trading in shares in person. Demat account enables smooth and convenient trading among investors who may be sitting thousands of km apart.

Just as banks service bank accounts, depositories of which there are two in India, namely National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) service demat accounts. However, there is one crucial difference. Whereas banks service accounts directly, Depositories service demat accounts through their agents called Depository Participants (DP).

2.13 DELIVERY INSTRUCTION SLIP (DI SLIP)

Let us go few years back in the journey of financial transactions in India before the advent of internet banking. During those times, if one wanted to transfer an amount to another person, one of the possible options was to write a cheque in favor of the other person. What kind of information does a cheque contain? Other than information pertaining to the person whose account the cheque book relates to, the cheque needs to be filled in with the accurate name of the person we want to credit the amount to. In order to ensure credit of the amount we also needed to know the bank with which the other person has an account and possibly needed to visit the bank in person.

What do we do instead after internet banking and UPI? We typically only know the mobile number of the person we want to transfer amount to. That and a bank account linked with a mobile

There has been a similar journey in the case of trading in shares. Before the advent of demat accounts, physical Delivery Instruction Slips (DI Slips) performed the same role as a cheque. If a shareholder wanted to transfer shares to another person, he needed to fill in the details of the share, the number of shares etc. on the DI Slip. With demat accounts however, this process has been simplified with online DI slips on which much of the information is pre-filled and the chances of error or rejection of DI slips are negligible now.

IN-TEXT QUESTIONS

25. Depositories service demat accounts through their agents called depository _____.
26. Demat accounts enable both convenient storing and electronic trading of shares. True/ False
27. Physical DI slips can be equated with _____.

2.14 BUSINESS DAYS, PRE-OPENING SESSION & TRADING SESSION

Business Day is a common term used in share trading. As the name indicates, it is a day on which business (of trading) can be done. The best way to understand "Business Day" is to remember that Saturdays, Sundays and Bank Holidays are Non-Business Days and remaining (other than Non-Business Days) are all Business Days.

Pre-open session refers to a 15-minute window from 9 AM to 9:15 AM. This window comprises Order Collection Period and Order Matching Period. During Order Collection Period, as the name suggests, orders (for sale/purchase) can be entered, modified and cancelled. During this period, orders can be placed only in equity segment. During Order Matching Period, as the name indicates, orders are matched. The intent behind introduction of pre-open session is to avoid extreme movement in share prices on the opening of stock markets.

Trading session also called regular trading session commences at 09:15 AM and concludes at 3:30 PM on every Business Day. During this period, regular trading in shares and other segments is allowed.

IN-TEXT QUESTIONS

28. Pre-open session refers to a __ minutes window
29. Pre-open session comprises Order ____ Period and Order _____ Period.
30. Trading session commences at ____ AM on every Business Day.

2.15 OPENING PRICE & CLOSING PRICE

The best way of understanding Opening Price and Closing Price is to reverse the sequence. We know that the Trading Session lasts from 09:15 AM to 3:30 PM on every Business Day. Depending on their assessment of relevant factors parties trading in stock markets fairly often trade the same share at slightly different prices. So, the obvious question that arises is how do we determine the closing price of a share? The simple arithmetical tool used to determine the closing price is weighted average. So, what happens is that the weighted average of the price at which a share has traded in the last 30 minutes of a Business Day (3 PM to 3:30 PM) is calculated and that is set as the Closing Price of the share. Let us understand this with the help of an illustration:

In the last 30 minutes of a Business Day, shares of 'ABCD' company witness the following trades:

Time	**Price**	**Volume (number of shares)**	**Trade Value (Price X number of shares)**
3:00 PM	50	20	1,000
3:05 PM	55	10	550
3:20 PM	50	20	1,000
3:30 PM	55	10	550
Total		60	3,100

Closing Price = Weighted Average Price = Total Trade Value / Total Volume

= 3,100 /60 = 51.67

From the above illustration, it can be seen that the closing price is Rs 51.67/- which is different from both 50 and 55, the two different prices the share has traded at, during the last 30 minutes. It is also different from 55 which is the last traded price (LTP).

We have read that regular trading session commences at 09:15 AM on every Business Day. Now that we know how the Closing Price of a share is determined, would the Opening Price of the share just be equal to the Closing Price from the previous day? The answer is NO. In case you are wondering why there may be a difference between Closing Price and Opening Price of the same share, you need to understand two aspects.

One, Opening Price is the price at which the share first trades during the Trading Session. Two, as we have already read, before the regular trading session, there is a Pre-Opening Session. What happens during the Pre-Opening Session? Orders are collected and matched.

From the last Business Day to the next Business Day, particularly until the Pre-Opening Session, the world doesn't stop. So many events- economic, political and otherwise; impact the prospects of companies. All the available information whether it is specific to the company or economy as a whole, influences the expectations of persons and institutions trading in share markets.

Therefore, during the pre-opening session, while orders are being collected, the demand for a share may be much more than the supply in which case the Closing Price may see an uptick and Opening Price may be greater than the Closing Price. Conversely, due to negative events, the rush to sell the share may be far greater than demand in which case the Closing Price would dip and Opening Price would be lower than the Closing Price.

IN-TEXT QUESTIONS

31. Closing Price of a share is the simple average of trades in the last 30 minutes of the trading session. True/False
32. Closing Price on the previous day would be the same as the Opening Price on the next day. True/ False
33. Closing Price of a share is determined by ____ and ______.
34. During pre-opening session, if the demand for a share is more than the number of shares available for trading, the Opening Price would be ___ than the Closing Price.

2.16 BLUE CHIP STOCKS & DEFENSIVE STOCKS

'Blue chip' is a term borrowed from card game of poker where blue colored chips are traditionally those with the highest value. Oliver Gingold, an employee of Dow Jones is credited with coining the term 'Blue Chip' in early 1920s. One traditionally accepted description of blue-chip companies/stocks is that it is a company which has a reputation for good performance in terms of quality of its earnings, reliability of its operations and its ability to operate profitably despite changes in the broader economic context. A long track record of profits is generally considered one important parameter for ascertaining whether a stock is a blue-chip stock or not.

Defensive stocks are those which deliver returns (in the form of dividends, capital appreciation etc) irrespective of the performance of wider economy and stock markets. There may be overlaps between blue-chip stocks and defensive stocks i.e., the same stock may be a defensive stock as well as a blue-chip stock. What distinguishes defensive stocks is that these companies typically sell products and services considered essential. Because of being considered essential, an economic downturn is expected not to affect such companies as badly as it would affect other companies.

2.17 BULL, BEAR, BULL MARKET, BEAR MARKET & STOP-LOSS

These are perhaps one of the most used terms in financial reporting today. A bull is considered to be someone who expects that prices of share would rise and buys shares in such expectation of a price rise. If more and more traders behave like bulls, the resulting demand for share would actually lead to price rise in shares as the number of shares available for trading are limited.

Conversely, someone who expects decline in prices of shares is called a bear. A bear would sell shares in anticipation of decline in share price.

The terms Bull Market and Bear Market derive their meaning from the sense in which terms bull and bear are used. A bull market is a market in which share prices are rising and general conditions in the economy are favourable for growth. On the other hand, a bear market is one where shares are declining in price and economic growth is slowing.

Stop-loss simply enables one to stop the loss. It is a feature available on demat accounts in the form of an advance order to sell a share when it reaches a particular price. It is a tool that to some extent does away with the need to monitor prices of shares on a regular basis. The trade would get triggered automatically on the stop-loss price. Let us see how this works in practice with the help of an illustration:

'A' holds certain number of shares of 'ABCD' company trading at Rs 100/-. 'A' had bought these shares at Rs 80/- so he has already made a notional profit. 'A' would ideally want to wait for some more time in the expectation of further increase in the price of the share. However, to be on the safer side, 'A' places a stop-loss sell order at Rs 95/-. The moment price of the share reaches Rs 95/- an order to sell will automatically be executed. This would lose 'A' from loss.

IN-TEXT QUESTIONS

35. Oliver Gingold is credited with coning the term ______.
36. A long track record of profits is generally considered one important parameter for ascertaining whether a stock is a blue-chip stock. True/ False
37. Defensive stock companies typically sell items of discretionary purchase. True/False
38. If more and more traders behave like bulls, it would actually lead to ____ in prices of shares.
39. Successful usage of stop-loss order requires regular monitoring of share prices. True/False
40. Stop-loss order would be of no use in a bull market. True/False

2.18 DERIVATIVES

Derivative reminds one of 'derive' which is a common word and for a good reason. Derivative in the world of finance refers to a contract that derives its value from one or more asset or reference point. Derivatives is a broad category with several different types of derivatives. There are a number of criteria on which derivatives can be distinguished: on the nature of obligations: futures, options, call, put etc.; the asset the derivative derives its value from: financial or commodity, and several others. While several types of derivatives form separate subjects of study in themselves, it is useful to be aware of certain kinds of derivatives. Let us consider an illustration to understand one type of derivative called futures:

On 1st April 2022, Company 'A' which manufactures edible products such as biscuits out of wheat buys a futures contract for wheat at Rs 2,200 per quintal from Company 'B' which is a wholesale grain merchant. This contract expires on per barrel that expires on 1st October 2022. The company does this because it needs wheat in October and is concerned that the price of wheat will rise before the company needs to buy. Buying a wheat futures contract protects company 'A' from the risk of price of wheat increasing beyond Rs 2,200 per quintal. Company 'B' is obliged to supply wheat to company 'A' for Rs 2,200/- per quintal once the contract expires i.e., on 1st October 2022. If the price of wheat increases to Rs 2,500/- per quintal in October, company 'A' stands to gain in the form of lower price of purchase. Other than that, company 'A' can also sell the 'futures contract' to another party. What do you think the price of this futures contract will depend on? The answer is the current price of wheat at a point of time. The higher the current price, the more the value of futures contract. Going back to the basic question of what a derivative is, in this case we have a contract to buy/ sell wheat after a certain date in future at a given price and the value of this contract is "derived" from the current price of wheat.

2.19 CALL OPTION & PUT OPTION

Suppose you want to clear a competitive examination, and not only do you want to clear it, but you also want to be one among the toppers. Given your aspiration, will you say that hard work is an option? No, you won't. Hard work is a requirement and no longer an option because option means you have the scope to choose to do or not do something.

The above example serves us well to understand what an option is. It is basically an agreement that gives one party the right but not the obligation to buy or sell. Why else would we use the term "option" in describing such an agreement!!

Now, in terms of sale and purchase there are broadly two options: sell or buy. The difference between call and put option is basically this. While a call option gives the holder of the option, the right to buy; a put option gives the holder of the option, the right to sell. Remember, both call and put are options- only right, but no obligation. Let us consider an illustration to understand call and put options even more clearly.

A trader offers you an option to buy 100 shares of 'ABCD' company at Rs 50/- each after the expiry of the option term of six months. The trader would charge Rs 500/- as his fee on the option. The share is currently trading at Rs 40/- and you expect the price to rise rapidly in the next six months or so. You pay Rs 500/- to the trader and buy the option. At the end of six months, when the share is trading at Rs 65/- you buy 100 shares at Rs 50/- and then sell all 100 shares at Rs 65/-. How much would you gain in the process?

Cost price = 100 X 50 = 5,000 (cost of shares as per the options contract) + 500/- (Trader's fee) = 5,500

Sale price = 100 X 65 = 6,500

Thus, you have gained Rs 1,000/- which is a handsome 18.18% of the cost price.

This is an example of a Call Option. You had the option (but not the obligation) to buy shares which you did as you expected the price of shares to increase much beyond the price quoted by the trader. Similarly, there are put options which enable a person to exercise the option to sell an asset at a pre-determined price.

IN-TEXT QUESTIONS

41. Derivative refers to a contract that derives its value from one or more asset or reference point. True/ False
42. While a call option gives the holder of the option, the right to buy; a put option gives the holder of the option, the right to sell. True/ False

2.20 HOLDING PERIOD

Holding period, put simply, is the period or duration for which an investor holds the investment before selling it. You may ask why should holding period matter at all? Let us consider the following illustration to understand why holding period is important.

'A' has a surplus of Rs 10,000/-. There are 2 investment options available to him. In option (1) amount Rs 10,000/- would double in 8 years and in option (2) the amount would double in 9 years. If you were in A's place, which option would you choose? You would obviously choose option (1) because the same result would be achieved in shorter period of time i.e., shorter holding period. This basic intuitive answer apart, there is also arithmetical logic to support the choice. If you calculate, you will find that in option (1), the interest rate is almost 9% whereas in option (2), the interest rate is almost 8%.

The above illustration captures one reason why holding period is important i.e returns. There is another reason why holding period is important: taxation. Depending on your holding period, the tax you are liable to pay may be more or less. We will explore this in greater detail in the next segment on short-term/long-term capital gains tax.

2.21 SHORT-TERM/ LONG-TERM CAPITAL GAINS TAX

We have discussed the concept of Holding Period. Whether a capital gain (gain earned by selling shares is a capital gain) is 'short-term' or 'long-term' depends on the holding period. If the holding period is less than 12 months that is if the date of purchase and date of sale of shares are less than 12 months apart, the gain on sale of shares would be short-term capital gain. If the holding period is more than 12 months, similar gain on sale of shares would be long-term capital gain.

The rate of tax applicable on short-term and long-term capital gain depends on changes in Income Tax effected during Annual Budget. Currently, short-term capital gain is taxed at 15%. Long-term capital gain tax is levied on capital gain in excess of Rs 1 lakh, at the rate of 10%.

IN-TEXT QUESTION

43. ____ period is the period or duration for which an investor holds the investment before selling it.
44. Holding period is important only for checking the rate of return. True/ False
45. A capital gain on sale of shares in case the holding period less than 12 months is called Short-term Capital gain. True/False

2.22 ANSWERS TO IN-TEXT QUESTIONS

In-text Q No	Answer	In-text Q No	Answer
(1)	False	(2)	False
(3)	unpaid	(4)	Dividend
(5)	False	(6)	20
(7)	Profit	(8)	Record
(9)	Amount	(10)	Face
(11)	True	(12)	True
(13)	Stock split	(14)	True

(15)	False	(16)	True
(17)	Coupon	(18)	Floating
(19)	Less	(20)	False
(21)	Capitalisation	(22)	False
(23)	True	(24)	True
(25)	Participants	(26)	True
(27)	Cheque	(28)	15
(29)	Matching; Collection	(30)	09:15
(31)	True	(32)	False
(33)	Volume; Trade Value	(34)	More
(35)	Blue-chip	(36)	True
(37)	False	(38)	Increase
(39)	False	(40)	False
(41)	True	(42)	True
(43)	Holding	(44)	False
(45)	True		

2.23 SELF-ASSESSMENT QUESTIONS

1. Explain the differences between Equity Shares and Preference Shares.
2. Discuss the events that lead to the payment of dividend.
3. Assess these from the perspective of shareholders: declaration and payment of dividend, issue of bonus share and stock split.
4. Compare zero coupon debentures, fixed coupon debentures and floating rate debentures.
5. How have DEMAT accounts eased the process of holding and trading shares?
6. Explain with the help of an illustration how Closing Price of a share is determined.
7. How is stop-loss beneficial for small investors?
8. How can you use Holding Period to compare investment options?

2.24 REFERENCES

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