UNIT 1

OVERVIEW OF FINANCIAL MARKET

Financial Markets are an important component of financial system in an economy Financial system aims at establishing a regular, smooth, efficient and cost effective link between savers & investors. Thus, it helps encouraging both saving and investment. All system facilitates expansion of financial markets over space 8 time and promote efficient allocation of financial resources. For socially desirable and economically productive purposes. They influence both the quality and the pace of economic development.

Various constituents of financial system are financial, institutions, financial services, financial instruments and financial markets. These constituents of financial system are closely inter-mixed and operate in conjunction with each other. For eg. Financial institutions operate in financial markets generating, purchasing and selling financial instruments and rendering various financial services in accordance with the practices and procedures established by law or tradition.

Financial markets are the centre or arrangements facilitating buying and selling of financial claims, assets, services and the securities. Banking and non – banking financial institutions, dealers, borrowers and lenders, investors and savers, and agents are the participants on demand and supply side in these markets. Financial market may be specific place or location, e.g. stock exchange or it may be just on over – the – phone market.

Generally speaking, there is no specific place or location to indicate a financial market. Wherever a financial transaction takes place, it is deemed to have taken place in the financial market. Hence financial markets are pervasive in nature since financial transaction are themselves very pervasive throughout the economic system. For instance, issue of equity shares, granting of loan by term lending, institutions, deposit of money into a bank, purchase of debentures, sale of shares and so on.

However, financial markets can be referred to as those centres and arrangements which facilitate buying and selling, of financial assets, claims and services. Sometimes, we do find the existence of a specific place or location for a financial market as in the case of stock exchange.

Classification of Financial Markets

The classification of financial markets in India is shown in Chart above.

Unorganised Markets :-In these markets there are a number of money lenders, indigenous bankers, traders, etc., who lend money to the public. Indigenous bankers also collect deposits from the public. There are also private finance companies, chit funds etc., whose activities are not controlled by the RBI. Recently the RBI has taken steps to bring private finance companies and chit funds under its strict control by issuing non-banking financial companies (Reserve Bank) Directions, 1998. The RBI has already taken some steps to bring the unorganised sector under the organised fold. They have not been successful. The regulations concerning their financial dealings are still inadequate and their financial instruments have not been standardised.

Organised Markets:-In the organised markets, there are standardised rules and regulations governing their financial dealings. There is also a high degree of institutionalisation and instrumentalisation. These markets are subject to strict supervision and control by the RBI or other regulatory bodies.

These organised markets can be further classified into two. They are:
(i) Capital market
(ii) Money market

Capital Market

The capital market is a market for financial assets which have a long or indefinite maturity. Generally, it deals with long term securities which have a maturity period of above one year. Capital market may be further divided into three namely:
(i) Industrial securities market
(ii) Government securities market and
(iii) Long term loans market

(i) Industrial Securities Market

As the very name implies, it is a market for industrial securities namely: (i) Equity shares or ordinary shares, (ii) Preference shares, and (iii) Debentures or bonds. It is a market where industrial concerns raise their capital or debt by issuing appropriate instruments. It can be further subdivided into two. They are:
(i) Primary market or New issue market
(ii) Secondary market or Stock exchange

Primary Market

Primary market is a market for new issues or new financial claims. Hence, it is also called New Issue market. The primary market deals with those securities which are issued to the public for the first time. In the primary market, borrowers exchange new financial securities for long term funds. Thus, primary market facilitates capital formation.
There are three ways by which a company may raise capital in a primary market. They are:
(i) Public issue
(ii) Rights issue
(iii) Private placement
The most common method of raising capital by new companies is through sale of securities to the public. It is called public issue. When an existing company wants to raise additional capital, securities are first offered to the existing shareholders on a pre-emptive basis. It is called rights issue. Private placement is a way of selling securities privately to a small group of investors.

Features of Primary Market are:-

1. This is the market for new long term capital. The primary market is the market where the securities are sold for the first time. Therefore it is also called New Issue Market (NIM).
2. In a primary issue, the securities are issued by the company directly to investors.
3. The company receives the money and issue new security certificates to the investors.
4. Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.
5. The primary market performs the crucial function of facilitating capital formation in the economy.
6. The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as ‘going public’.

Secondary Market

Secondary market is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally, such securities are quoted in the Stock Exchange and it provides a continuous and regular market for buying and selling of securities. This market consists of all stock exchanges recognised by the Government of India. The stock exchanges in India are regulated under the Securities Contracts (Regulation) Act, 1956. The Bombay Stock Exchange is the principal stock exchange in India which sets the tone of the other stock markets.

Features of Secondary Market

a) **It Creates Liquidity:**
The most important feature of the secondary market is to create liquidity in securities. Liquidity means immediate conversion of securities into cash. This job is performed by the secondary market.

b) **It Comes after Primary Market:**
Any new security cannot be sold for the first time in the secondary market. New securities are first sold in the primary market and thereafter comes the turn of the secondary market.

c) **It has a Particular Place:**
The secondary market has a particular place which is called Stock Exchange. However, it must be noted that it is not essential that all the buying and selling of securities will be done only through stock exchange.
Two individuals can buy or sell them mutually. This will also be called a transaction of the secondary market. Generally, most of the transactions are made through the medium of stock exchange.

d) **It Encourages New Investment:**
The rates of shares and other securities often fluctuate in the share market. Many new investors enter this market to exploit this situation. This leads to an increase in investment in the industrial sector of the country.

(ii) Government Securities Market

It is otherwise called Gilt-Edged securities market. It is a market where Government securities are traded. In India there are many kinds of Government Securities - short-term and long-term. Long-term securities are traded in this market while short term securities are traded in the money market. Securities issued by the Central Government, State Governments, Semi-Government authorities like City Corporations, Port Trusts etc. Improvement Trusts, State Electricity Boards, All India and State level financial institutions and public sector enterprises are dealt in this market.

(iii) Long-Term Loans Market

Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customers. Longterm loans market may further be classified into:

I. Term loans market
II. Mortgages market
III. Financial guarantees market.

Term Loans Market

In India, many industrial financing institutions have been created by the Government both at the national and regional levels to supply long term and medium term loans to corporate customers directly as well as indirectly. These development banks dominate the industrial finance in India. Institutions like IDBt IFCt ICICI, and other state financial corporations crone under this category. These institutions meet the growing and varied long-term financial requirements of industries by supplying long-term loans. They also help in identifying investment opportunities, encourage new entrepreneurs and support modernisation efforts.

Mortgages Market

The mortgages market refers to those centers which supply mortgage loan mainly to individual customers. A mortgage loan is a loan against the security of immovable property like real estate. The transfer of interest in a specific immovable property to secure a loan is called mortgage. This mortgage may be equitable mortgage or legal one. Again it may be a first charge or second charge. Equitable mortgage is created by a mere deposit of title deeds to properties as security whereas in the case of a legal mortgage the title in the property is legally transferred to the lender by the borrower. Legal mortgage is less risky.

Financial Guarantees Market

A Guarantee market is a centre where finance is provided against the guarantee of a reputed person in the financial circle. Guarantee is a contract to discharge the liability of a third party in case of his default. Guarantee acts as a security from the creditor's point of view. In case the borrower fails to repay the loan, the liability falls on the shoulders of the guarantor. Hence the guarantor must be known to both the borrower and the lender and he must have the means to discharge his liability.

Though there are many types of guarantees, the common forms are: (i) Performance Guarantee, and (ii) Financial Guarantee. Performance guarantees cover the payment of earnest money, retention money, advance payments, non-completion of contracts etc. On the other hand financial guarantees cover only financial contracts.

FINANCIAL SERVICES

The term "Financial Services" in a broad sense means "mobilizing and allocating savings". Thus, it includes all activities involved in the transformation of saving into investment. The financial service can also be called 'financial intermediation'. Financial intermediation is a process by which funds are mobilised from a large number of savers and make them available to all those who are in need of it and particularly corporate customers. Thus, financial services sector is a key area and it is very vital for industrial developments.

Definition

The term financial services can be defined as the activities, benefits, satisfaction connected with the sale of money, that offer to users or customers, financial related values.

NATURE OR CHARACTERISTICS OF FINANCIAL SERVICES

The financial services has the following characteristics:

1. **INTANGIBLE:** Financial services cannot appeal to a buyer’s sense of touch, taste, smell, sight or hear. Thus an organization providing financial services is largely dependent on the feedback from the public as to effectiveness, quality and attractiveness of the services rendered.

2. **DIRECT SALE:** Direct sale is the only possible channel of distribution. There are no middleman in between. In order to ensure that the services are available at the right time and the right place, simultaneous production and distribution of financial services is undertaken by the service organization.
3. **HETROGENITY**: In order to provide a variety of financial and related needs of different customers in different areas financial service organization has to offer a wide range of products and services. They provide special services to industrial customers and retail services covering insurance money receipt or storage etc.
4. **FLUCTUATION IN DEMAND:** The demand for certain categories of financial services ex. Life insurance, its demand fluctuate according to the level of general economic activity. This factor puts extra pressure on the role & functions of marketing and insurance organization.
5. **PROTECT CUSTOMERS INTEREST:** The responsibility of any financial service organization to protect customers interest is important not just in banking and insurance but also in other sectors of the financial services.
6. **LABOUR INTENSIVE:** Personalized services versus automation is an important issue in financial services. The financial service sector is highly labour intensive. It leads to increase in cost of production and consequently affect the price of financial products. Because of high personnel cost involved and to enhance customers convenience increased use of technology is being made.
7. **GEOGRAPHICAL DISPERSION**: Financial services must have both appeal and wider application. To ensure this the service providing organization must have massive branch network so that benefits of convenience are enjoyed by international, national and local customers.
8. **LACK OF SPECIAL IDENTITY:** Customers usually approach a nearby branch of a bank or financial institution because it is convenient to them. As the competing product offered by various service organizations are similar the emphasis is more on the package than the product. The package consists of branch location, staff, services, reputation, advertising and new services offered from time to time. Thus, major competitors offering similar services place more emphasis on the promotional aspects rather than on the inherent uniqueness of a particular financial institution's service.
9. **INFORMATION BASED:** Financial service industry is an information based industry. It involves creation and use of information. Information is an essential component in the production of financial services. Cost of processing information is quite relevant in the profitable production of financial services.
10. **REQUIRE QUALITY LABOUR:** Financial services require huge amounts of high quality labour to deal with information & communication with the market. The type of labour range from workers performing simple task to those undertaking complex analysis and negotiations require years of training and experience. The importance of labour cost and the role of human inputs in financial service production can be realized from the salaries paid in this industry. Financial services firms have to make extra efforts to attract, motivate, and retain the human resources they require in order to survive, grow and prosper in future.

TYPES OF FINANCIAL SERVICES

As we have seen earlier financial services are offered by various financial organization or institutions, commercial banks and merchant bankers. These financial services can be classified into two types basically:

1. Asset based/fund based
2. Fee based/advisory services

ASSET BASED / FUND BASED SERVICES

These financial services includes all such type of services which involves investment in some kind of physical asset for which the payment is being made either in future or at present in full or partial in the form of interest or dividend. It involve some kind of assets.

1. **LEASING FINANCE:** Leasing is an arrangement that provides a firm with the use and control over assets without buying and owing the same. “A lease is a contract between the owner of the asset (lessor) and the user of the asset(lessee), whereby the lessor gives the right to use the asset to the lessee over an agreed period of time for a consideration called the lease rental. The lessee pays the lease rent periodically to the lessor as regular fixed payments over a period of time as mentioned in the terms and conditions of the agreement. At the expiry of the lease period the asset reverts back to the lessor or the lessee may buy the asset.

   So, leasing is an alternative to purchase of an asset in order to acquire the services of that asset.

   Leasing is a process by which a firm can obtain the use of certain fixed asset for which it must make a no. Of contractual, periodic & tax deductible payments.

2. **HIRE PURCHASE:** Hire purchase is an alternative to leasing as a source for equipment financing. Hire purchase means a transaction where goods are purchased and sold on the terms that:

   Payment will be made in installments.

   The possession of the goods is given to the buyer immediately.

   The property(ownership) in the goods remains with the vendor till the last installment is paid.

   The seller can repossess the goods in case of default in any payment of any installments.

   Each installment is treated as hire charges till the last installment is paid.

3. **BILL DISCOUNTING**: According to Indian Negotiable Instruments Act 1881, the bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay a certain sum of money to, or to the order of, a certain person, or to the bearer of that instrument. The bill of exchange is used for financing a transaction in goods which means that it is essentially a trade related instrument.

   Discounting of B/E is a fund based financial service provided by finance companies. The act of handling over an endorsed B/E for ready money is called discounting of bill. The margin between the ready money paid and the face value of the bill is called the discount rate and is calculated as a rate percentage per annum on the maturity value. The maturity of a bill of exchange is defined as the date on which payment will fall due. Normal maturity periods are 30, 60, 90, 120 days bills maturing within 90 days is most popular.

   CREATION OF B/E: Suppose a seller sells a good or merchandise to buyer. In most cases, the seller would like to be paid immediately but the buyer would like to pay only after sometime, that is the buyer would wish to purchase on credit. For this problem the seller draws a B/E of a given maturity on the buyer. The seller has now assumed the role of a creditor and is called the drawer of the bill. The buyer who is the debtor is called the drawee. The seller then sends the bill to the buyer who acknowledges his responsibility for the payment of the amount on the terms mentioned on the bill by writing his acceptance on the bill. The acceptor could be the buyer himself or any third party willing to take on the credit risk of the buyer.

4. **CONSUMER CREDIT:** Consumer credit includes all asset based financing plans offered to individuals to help them acquire durable consumer goods. In a consumer credit transaction the individual/consumer/buyer pays a part of cash purchase price at the time of delivery of the asset and pays the balance with interest over a specified period of time. The main providers of consumer credit are foreign/multinational banks, commercial banks and finance companies & cover items such as cars, scooters, vcrs, tvs, refrigerators, washing machines, home appliances, personal computers, cooking ranges, food processors etc.

5. **VENTURE CAPITAL:** Venture capital is a form of financing designed for funding high technology, high risk and perceived high risk projects. The term venture capital represents financial investments in a highly risky projects with the objective of earning a high rate of return. A venture capitalist provides funds to entrepreneurs & enterprises pursuing new and unexplored avenues. They helps the promote to actualize the project and attain commercialization. Financial support s extended not only as a conventional loan with fixed repayment schedules, but also in the form of equity or quasi-equity instruments with a conscious intention of sharing the rewards as well as the risks with the sponsor of the project. Financier provides management support to establish the venture successfully. Thus V.C. is a medium for translating the entrepreneurial ideas from research laboratory stage to the production line and further on to get the products to the market.

   There is significant scope for venture capital companies in our country because of increasing emergence of technocrat entrepreneurs who lack capital to be risked. These venture capital companies provide the necessary risk capital to the entrepreneurs so as to meet the promoters contribution as required by the financial institutions. In addition to providing capital, these firms take an active interest in guiding the assisted firms. Some V.C. firms are:-

   - Venture capital fund of IDBI
   - Technology development & information corporation of India ltd.(ICICI) & (UNIT TRUST)
   - Risk capital & technology corporation ltd (RCTC)
   - Infrastructure leasing and financial services ltd.
   - Stock holding corporation of India ltd. (SHCIL)
   - The credit rating information services of India ltd.(CRISL)

6. **HOUSING FINANCING**: Housing finance has merged as a fund based financial service in the country with the setting up of National Housing Bank (NHB) by RBI in 1988 whose main objective is to provide finance for house building. The main components of the housing finance system are the NHB, the HUDCO Housing and urban development corporation, Insurance organizations, commercial and co-operative banks & specialized Housing finance institution in the public private and joint sector such as HDFC, Citi Home, Dewan Housing Finance and so on.

7. **INSURANCE SERVICES**: Insurance is a contract whereby the insurer that is insurance company agrees/undertakes in, consideration of a sum of money (premium), to make good the loss suffered by the insured (policy holder) against a specified risk such as fire or compensate the beneficiary (insured) on the happening of the specified event such as accident or death. The document containing the terms of contract between the insurer and the insured is called policy. The property which is insured is the subject matter of

insurance. The interest which the insured has in the subject matter of insurance is known as insurable interest. Depending on the subject matter, insurance services are divided into:-

Life

General

Initially there were only two public organization LIC & GIC but with the setting up of IRDA (Insurance regulatory & development authority) new ventures came into existence.

8. **FACTORING:** Factoring may broadly be defined as the relationship created by an agreement, between the seller of goods & services and a financial institution called a factor, whereby the later purchases the receivables of the former and also control and administers the receivables of the former.

Factoring as a fund based financial service, provides resources to finance receivables as well as facilitates the collection of receivables. It is another method of raising short term finance through account receivables credit offered by commercial bank and factors. A factor is a financial institution which offers services relating to management and financing of debts arising out of credit sales. At present following companies operate in this field:-

- Canbank Factors Ltd
- SBI factors and commercial services pvt ltd
- HSBC
- Foremost factors ltd
- SIDBI
- Standard chartered bank
- Global trade finance

FEE BASED / ADVISORY SERVICES

In fee based services there is no physical asset only advisory services are given. And for those advisory services payment is given to the service provider as a fees for the services or advice.

1. **PORTFOLIO MANAGEMENT:** These services are offered not only to the companies issuing the securities but also to the investors. They advice their clients, mostly institutional investors, regarding investment decision as the quantum of amount of security and the type of security in which to invest. They renders necessary services to the investors by advising on the optimum investment mix, taking into account factors like: objectives of the investment, tax bracket applicable to the investor, need for maximizing returns, capital appreciation etc. Thus such firms undertake the function of purchase and sale of securities for their clients so as to provide them portfolio management services. Some firms manage mutual funds and offshore funds.

2. **CORPORATE COUNSELING:** This advice is usually provided to corporate unit. Such firms render advice to corporate enterprises from time to time in order to improve performance and build better image/reputation among investors and to increase the market value of its equity shares. Counseling is provided in the form of opinions, suggestions and detailed analysis of corporate law as applicable to the business units. In India Punjab National Bank is one of the examples.

3. **ISSUE MANAGEMENT:** This service is mainly confined to management of new public issues of corporate securities by the newly formed companies, existing companies and foreign companies in dilution of equity. These firms acts as sponsors of the issues. They

obtain consent of the controller of capital issues which is SEBI and provide a number of services to ensure success in the marketing of the securities. The services provided are:-

- Preparation of prospectus
- Preparation of plan and budget of issues
- Selection of institutional and broker underwriters and underwriting agreements
- Advertising and arranging publicity agency for post and pre issues
- Selection of issue house
- Advising clients regarding a fresh issue, additional issues, bonus and write issues.
- Take decision as to the size and timing of the public issues

4. CORPORATE RESTRUCTURING: The growth of the firm can be achieved internally either by developing new products or externally by acquisitions, mergers, amalgamations, absorption and so on. The activities related to the expansion and contraction of a firms operations or changes in its assets or financial or ownership structure are referred to as corporate restructuring. And the most common forms of corporate restructuring are merger/demergers, amalgamations & acquisition/ takeovers, buyouts or financial restructuring.

5. CREDIT RATING: Credit rating agencies are the institutions that rate the companies or firms for their creditworthiness. Credit rating is the opinion of the rating agency on the relative ability and the willingness of the issuer of a debt instrument to meet the debt service obligations as and when they arise. It is an indicator expressing the underlying credit quality of a debt issue program.

The business firm can raise funds at a cheaper rate with a good rating. The fund ratings are useful to the banks and other financial institutions when they decide on lending and investment strategies. A company with highly rated instruments ahs to make least efforts in raising funds through public. In India, there are three major credit raising agencies namely CRISL-Credit rating information service of India ltd, ICRA-Investment information and credit rating agency of India ltd, CARE- Credit analysis and research.

6. STOCK BROKING: Since SEBI was setup stock broking has emerged as a professional advisory service. Stock broking is a member of a recognized stock exchange who buys, sell or deals in shares/securities. There are many stock broking firms in India which gives advisory service to its clients regarding investment in securities. Thus the broker are the intermediary between the investor and the stock market. The brokers invest in the securities on behalf of the investor and charges fees/ commission for those services. These brokers are registered with SEBI and they are abide by its rules, regulations and by-laws.

7. LOAN SYNDICATION: Some institutions provides specialized services in preparation of project, loan applications for raising short term as well as long term credit from various banks and financial institutions for financing the project or meeting the working capital requirements. Loan syndication involves following services:

a) Assisting the clients in the estimation of total cost on the project and prepare financial plan to meet that cost.

b) Assisting clients in the preparation of loan application for financial assistance from term lenders/ financial institutions/ banks and monitoring their progress.

c) Follow up of the term loan application with the financial institution and banks and obtaining the satisfaction for their share of participation.

d) Assisting the client for negotiation for the sanction of appropriate facilities.

UNIT 2

Money Market
There are two types of financial markets viz., the money market and the capital market. The money market in that part of a financial market which deals in the borrowing and lending of short term loans generally for a period of less than or equal to 365 days. It is a mechanism to clear short term monetary transactions in an economy.

Definitions of Money Market
Following definitions will help us to understand the concept of money market.
According to **Crowther**, "The money market is a name given to the various firms and institutions that deal in the various grades of near money."

According to the **RBI**, "The money market is the centre for dealing mainly of short character, in monetary assets; it meets the short term requirements of borrowers and provides liquidity or cash to the lenders. It is a place where short term surplus investible funds at the disposal of financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government."

According to **Nadler and Shipman**, "A money market is a mechanical device through which short term funds are loaned and borrowed through which a large part of the financial transactions of a particular country or world are degraded. A money market is distinct from but supplementary to the commercial banking system."
These definitions help us to identify the basic characteristics of a money market. A money market comprises of a well organized banking system. Various financial instruments are used for transactions in a money market. There is perfect mobility of funds in a money market. The transactions in a money market are of short term nature.

Functions of Money Market
Money market is an important part of the economy. It plays very significant functions. As mentioned above it is basically a market for short term monetary transactions. Thus it has to provide facility for adjusting liquidity to the banks, business corporations, non-banking financial institutions (NBFs) and other financial institutions along with investors.

The major functions of money market are given below:-
1. To maintain monetary equilibrium. It means to keep a balance between the demand for and supply of money for short term monetary transactions.
2. To promote economic growth. Money market can do this by making funds available to various units in the economy such as agriculture, small scale industries, etc.
3. To provide help to Trade and Industry. Money market provides adequate finance to trade and industry. Similarly it also provides facility of discounting bills of exchange for trade and industry.
4. To help in implementing Monetary Policy. It provides a mechanism for an effective implementation of the monetary policy.
5. To help in Capital Formation. Money market makes available investment avenues for short term period. It helps in generating savings and investments in the economy.
6. Money market provides non-inflationary sources of finance to government. It is possible by issuing treasury bills in order to raise short loans. However this dose not leads to increases in the prices.

Apart from those, money market is an arrangement which accommodates banks and financial institutions dealing in short term monetary activities such as the demand for and supply of money.

Indian Money Market - Features

Every money is unique in nature. The money market in developed and developing countries differ markedly from each other in many senses. Indian money market is not an exception for this. Though it is not a developed money market, it is a leading money market among the developing countries.

Indian Money Market has the following major features or characteristics :-

1. **Dichotomic Structure** : It is a significant aspect of the Indian money market. It has a simultaneous existence of both the organized money market as well as unorganised money markets. The organized money market consists of RBI, all scheduled commercial banks and other recognized financial institutions. However, the unorganized part of the money market comprises domestic money lenders, indigenous bankers, trader, etc. The organized money market is in full control of the RBI. However, unorganized money market remains outside the RBI control. Thus both the organized and unorganized money market exists simultaneously.
2. **Seasonality**: The demand for money in Indian money market is of a seasonal nature. India being an agriculture predominant economy, the demand for money is generated from the agricultural operations. During the busy season i.e. between October and April more agricultural activities takes place leading to a higher demand for money.
3. **Multiplicity of Interest Rates** : In Indian money market, we have many levels of interest rates. They differ from bank to bank from period to period and even from borrower to borrower. Again in both organized and unorganized segment the interest rates differs. Thus there is an existence of many rates of interest in the Indian money market.
4. **Lack of Organized Bill Market**: In the Indian money market, the organized bill market is not prevalent. Though the RBI tried to introduce the Bill Market Scheme (1952) and then New Bill Market Scheme in 1970, still there is no properly organized bill market in India.
5. **Absence of Integration**: This is a very important feature of the Indian money market. At the same time it is divided among several segments or sections which are loosely connected with each other. There is a lack of coordination among these different components of the money market. RBI has full control over the components in the organized segment but it cannot control the components in the unorganized segment.
6. **High Volatility in Call Money Market**: The call money market is a market for very short term money. Here money is demanded at the call rate. Basically the demand for call money comes from the commercial banks. Institutions such as the GIC, LIC, etc suffer huge fluctuations and thus it has remained highly volatile.
7. **Limited Instruments**: It is in fact a defect of the Indian money market. In our money market the supply of various instruments such as the Treasury Bills, Commercial Bills, Certificate of Deposits, Commercial Papers, etc. is very limited. In order to meet the varied requirements of borrowers and lenders, It is necessary to develop numerous instruments.

INSTRUMENTS OF MONEY MARKET

TREASURY BILLS MARKET

Treasury bills are the instruments of short term borrowing by the Central/State Government. These are issued by Rbi and sold through fortnightly or monthly auction at varying discount rates depending upon the bids.

Treasury bills are promissory notes which are issued at discount and for fixed period. The rate of interest on treasury bills is market determined depending upon the demand and supply of funds in money market. In India treasury bills were first issued in the year 1917. Treasury bills are considered a highly liquid and safe investment and they are also being issued under the market stabilization scheme. Treasury bills are still in the underdevelopment stage in India as compared to the other countries.

Characteristics of Treasury Bills

1. T- Bills are short term instruments.
2. They are in the nature of deep discount instruments. They are issued to the investors at a discount.
3. They are highly liquid and safe investment

Merits of Treasury Bills

1. Safety- Investment in treasury bills is considered to be one of the safest investment as payment of maturity value is guaranteed by the government.
2. Liquidity- Investment in T-bills is also very liquid . Treasury bills can be easily converted into cash at any time at the option of the investor . The Discount & Finance House of india announces daily buying and selling rates for T-bills. They can be discounted with Rbi. Refinance facility is also provided by Rbi against T-bills.
3. Statutory Requirement- Commercial banks are required to maintain 25% of its net demand & time liabilities in the form of Government securities. It is known as Statutory Liquidity ratio. T- bills are eligible securities for SLR purposes. This helps in maintaining CRR also for the commercial banks.
4. Source of short term funds- T-bills are very useful source of short term funds for the government. It can meet its temporary budget deficits by issuing T-bills.
5. Non- inflationary Monetary tool- Central government can use T-bills as a tool in monetary policy to control liquidity.
6. Excess liquidity in the economy can be absorbed through the issue of T-bills.

Demerits of T-Bills

1. Poor yield- The yield on t-bills is the lowest. Long term government securities give more interest.
2. Absence of competitive bids- Though T-bills are sold through auction to ensure market rates to the investors, in actual practice, competitive bids are absent.
3. Absence of active Trading- Investors in T-bills prefer to hold them till maturity. Therefore active trading in T-bills is affected.

Types of T-Bills

There are different types of Treasury bills based on the maturity period and utility of the issuance.

In India, at present, the Treasury Bills are issued for the following tenors:→

- **91-days Treasury bills:**
  Ninety one days treasury bills are issued at a fixed discount rate of 4% as well as through auctions. 91 days treasury bills (top basis) can be rediscounted with the RBI at any time after 14 days of their purchase. Before 14 days a penal rate is charged.
- **182-days Treasury bills.**
  These bills were issued without any specified amount. These bills are tailored to meet the requirements of the holders of short term liquid funds. These bills were issued at a discount. These instruments were eligible as securities for SLR purposes. These bills have rediscounting facilities.
- **364-days Treasury bills.**
  364 days bills do not carry any fixed rate. The discount rate on these bills are quoted in auction by the participants and accepted by the authorities. Such a rate is called cut off rate.

Note:

- Treasury bills are available for a minimum amount of Rs.25,000
- In multiples of Rs. 25,000.
- T-bills auctions are held on *the Negotiated Dealing System (NDS)*
- Members electronically submit their bids on the system.
- Non-competitive bids are routed through the respective custodians or any bank which is an NDS member

Participants in the t- bill market

All entities registered in India

- RBI and SBI
- Commercial banks
- State Governments
- DFHI
- STCI
- Financial institutions like LIC, GIC, UTI, IDBI, ICICI, IFCI, NABARD, etc.
- Corporate customers
- Public

Though many participants, in actual practice, this market is in the hands at the banking sector. It accounts for nearly **90 %** of the annual sale of T-BILLS.

COMMERCIAL PAPERS

Commercial Paper is a short-term, unsecured negotiable instrument, consisting of promissory notes with a fixed maturity issued to raise cash by a large business firm that has high credit rating/standing. A CP when issued by a company directly to the investors is called a **direct paper**. When CPs are issued by security dealers, they are called **dealer paper**

In India, on the recommendation of the **Vaghul Working Group, RBI** introduced the commercial paper scheme in the Indian money market in 1989.

Features Of Commercial Papers

1. They are negotiable by endorsement and delivery and hence they are flexible as well as liquid instruments. Commercial paper can be issued with varying maturities as required by the issuing company.
2. They are unsecured instruments as they are not backed by any assets of the company which is issuing the commercial paper.

3. They can be sold either directly by the issuing company to the investors or else issuer can sell it to the dealer who in turn will sell it into the market.
4. It helps the highly rated company in the sense they can get cheaper funds from commercial paper rather than borrowing from the banks.
5. However use of commercial paper is limited to only blue chip companies and from the point of view of investors though commercial paper provides higher returns for him they are unsecured and hence investor should invest in commercial paper according to his risk -return profile.
6. It is issued at a discount to face value.
7. CP attracts stamp duty.
8. CP can be issued for maturities between 15 days and less than one year from the date of issue.
9. CP may be issued in the multiples of Rs.5 lakh.
10. No prior approval of RBI is needed to issue CP and underwriting the issue is not mandatory.
11. All expenses (such as dealers' fees, rating agency fee and charges for provision of stand-by facilities) for issue of CP are to be borne by the issuing company.

TYPES OF COMMERCIAL PAPERS:

Direct Papers: A direct commercial paper is issued directly by the company to the investors without any intermediary. Companies issuing direct papers announce the current rate of commercial paper with different maturities for investors to choose the CP that suits their requirement.

Dealer Papers: A dealer/merchant banker on behalf of a client issues these types of commercial papers. The dealer arranges for the private placement of the paper and also provides advisory services such as timing of the issue, determination of the discount rate and a suitable maturity period.

Companies and financial institutions tend to find alternative sources of funds whenever bank interest rates are higher than the interest rate prevailing in the market. Commercial paper is an easy, cheap and quick source of finance for these companies.

COMMERCIAL PAPERS

The introduction of commercial paper as debt instrument has promoted commercial paper market as one of the components of Indian money market. In this commercial paper market, the issuers of commercial paper create supply while the subscribers to commercial paper create demand for these papers. The interaction between supply and demand for commercial papers promotes the commercial paper market. The main issuers of Commercial paper in this market are corporate and the main subscribers to the Commercial papers are the banking companies. Commercial Paper is issued by the issuers at a discount to face value of Commercial paper. The face value of Commercial Paper is in the denomination of Rs. 0.5 million and multiples thereof. The maturity period of Commercial paper in the Commercial Paper market ranges between minimum of 15 days and maximum of 1 year from the date of issue. The subscriber to the commercial paper is the investor, and a single investor in the Commercial paper market is not allowed to invest less than Rs. 0.5 million. The other issuers of Commercial paper in this market are Primary dealers and All India Financial Institutions. The other investors or subscribers to Commercial paper in this market are individuals, Non-Resident Indians and Foreign Institutional Investors.

ISSUER OF COMMERCIAL PAPER: Corporate, primary dealers (PDs) and the All-India Financial Institutions (FIs) are eligible to issue CP.

ADVANTAGES OF COMMERCIAL PAPERS:

1) It is quick and cost effective way of raising working capital.
2) Best way to the company to take the advantage of short term interest fluctuations in the market
3) It provides the exit option to the investors to quit the investment.
4) They are cheaper than a bank loan.
5) As commercial papers are required to be rated, good rating reduces the cost of capital for the company.
6) It is unsecured and thus does not create any liens on assets of the company.
7) It has a wide range of maturity.

Disadvantages of commercial papers:

1) It is available only to a few selected blue chip and profitable companies.
2) By issuing commercial paper, the credit available from the banks may get reduced.
3) Issue of commercial paper is very closely regulated by the RBI guidelines.

Conclusion

The concept of raising money through commercial paper was known to the US markets since 20th century. On our country though it was introduced in 1990, the RBI constantly watching the growth of the CP market and it is modifying the guidelines from time to time. For further development of CP market, the stamp duty on CP should be abolished since there is no stamp duty in US, UK and France and RBI has to relax the stringent Credit Rating norms from the present Credit rating P2 of CRISIL to P3, since credit rating is not compulsory in many countries like US, UK and France. The denominations of CP should be reduced further for the growth of secondary market for CP.

CERTIFICATE OF DEPOSITS (CDs)

Introduced in India on 27th March, 1989

Definition

"Certificate of Deposits (CDs) is a negotiable money market instrument and issued in dematerialized form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period."

CDs are short-term borrowings in the form of Usance Promissory Notes having a maturity of not less than 3 months up to a maximum of one year.

CD is subject to payment of Stamp Duty under Indian Stamp Act, 1899 (Central Act). They are like bank term deposits accounts. Unlike traditional time deposits these are freely negotiable instruments and are often referred to as Negotiable Certificate of Deposits.

Issuers of certificate of deposits

CDs can be issued by the scheduled commercial banks and financial institutions

Buyers of the certificate of deposits

CDs can be issued to individuals, companies, trust funds, associations etc

Features of CD

1. CDs can be issued by all scheduled commercial banks except RRBs
2. Unsecured negotiable pronotes.

3. Document of title to time deposits.
4. Freely transferable by endorsement and delivery.
5. Repayable on fixed date without grace days.
6. CRR & SLR are to be maintained
7. CDs are subject to stamp duty.

Advantages
1. Safe short term investment
2. Highly liquid
3. Helps the banks to maintain their share in the financial market
4. Availability of secondary market
5. Ideal instruments for banks with short term surplus funds to invest at attractive rates.

Disadvantages
1. Stamp duty
2. Need for development of secondary market
3. Minimum lock-in period of 45 days is yet another problem.

DISCOUNT AND FINANCE HOUSE OF INDIA (DFHI)
The discount and Finance House of India was incorporated on March 9, 1988 under the Companies Act, 1956 and started its business operations weft 25th April, 1988. DFHI was set up jointly by the Reserve Bank of India, public sector banks and financial institutions with the primary objectives of deepening and activating the money market. Presently, it has its own paid- up capital of Rs,200 crore and authorized capital of Rs, 250 crore . RBI provides refinance facility to DFHI against the collateral security of treasury bills and eligible commercial bills.

Role or functions of DFHI
The primary objectives of DFHI are to stabilize the liquidity imbalances by developing primary and secondary money markets. DFHI performs the following functions DFHI integrates its main market at Mumbai with other markets at regional centre's through its strong network.

1. Depository of Surplus Funds Uses Surplus funds to even out imbalances in banking system
2. Provides Ready Market for commercial bills, Treasury Bills, Government guaranteed securities by purchasing and selling to the banks Acts as a specialized money market intermediary for boosting trading in money market
3. Discounts not only in commercial bills but also in treasury bills and other money market instruments Helps money market transactions for small and medium sized institutions Undertakes short-term buy back operations in government and approved dated securities
4. DFHI deals actively in all money market instruments. Its activities are restricted to: ·
   a) Dealing in 91 days and 364 days treasury bills(TBs) ·
   b) Rediscounting of short-term commercial bills ·
   c) Participating in call money market and term deposit ·
   d) Government dated securities ·

   e) Dealing in commercial paper(CP) and certificates of deposits(CDs
5. DFHI provides ready market for purchase or sale of TBs. it quotes regular bid and offer rates (two- way prices for purchase and sale) for treasury bills. DFHI participates in fortnightly auctions held for TBs. It's primary objectives is to develop secondary market for TBs so that corporate bodies and other institutions could invest their surplus funds in such bills.
6. DFHI imparts liquidity to commercial bills by rediscounting the bills already discounted by banks and financial institutions. It announces its bid and offers re-discount rates on a fortnightly basis.
7. DFHI renders services to banks in the call money market by arranging or placing funds for banks. It acts both as lender and borrower in the inter-bank call money market. It deals in overnight call and notice money up to 14 days.
8. Government Dated Securities: DFHI started dealing in government securities in 1992. It was permitted to act as primary dealer (PD) in feb 1996.
9. Market for financial guarantees: Creditors/ Suppliers of funds are always at risk of non-payment of loans by the debtors. In order to minimize the risk, they always insist on some guarantee by the third person so that in case, the principal debtors make a default in the repayment of loans, the guarantor becomes the debtor i.e. the guarantor becomes liable for repayment of loan capital.

RESERVE BANK OF INDIA

The origins of the Reserve Bank of India can be traced to 1926, when the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission – recommended the creation of a central bank for India to separate the control of currency and credit from the Government and to augment banking facilities throughout the country. The Reserve Bank of India Act of 1934 established the Reserve Bank and set in motion a series of actions culminating in the start of operations in 1935. Since then, the Reserve Bank's role and functions have undergone numerous changes, as the nature of the Indian economy and financial sector changed. Starting as a private shareholders' bank, the Reserve Bank was nationalized in 1949. It then assumed the responsibility to meet the aspirations of a newly independent country and its people. The Reserve Bank's nationalization aimed at achieving coordination between the policies of the government and those of the central bank.

Functions of RBI

As a central bank, the Reserve Bank has significant powers and duties to perform. For smooth and speedy progress of the Indian Financial System, it has to perform some important tasks. Among others it includes maintaining monetary and financial stability, to develop and maintain stable payment system, to promote and develop financial infrastructure and to regulate or control the financial institutions.

For simplification, the functions of the Reserve Bank are classified into the traditional functions, the development functions and supervisory functions.

Traditional Functions of RBI

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

1. **Issue of Currency Notes**: The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.
2. **Banker to other Banks**: The RBI being an apex monitory institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the last resort.
3. **Banker to the Government**: The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.
4. **Exchange Rate Management**: It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.
5. **Credit Control Function**: Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus it regulates the credit creation capacity of commercial banks by using various credit control tools.
6. **Supervisory Function**: The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new braches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks in India.

Developmental / Promotional Functions of RBI

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.

1. **Development of the Financial System**: The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient

financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

2. **Development of Agriculture**: In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).
3. **Provision of Industrial Finance**: Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.
4. **Provisions of Training**: The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.
5. **Collection of Data**: Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.
6. **Publication of the Reports**: The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.
7. **Promotion of Banking Habits**: As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.
8. **Promotion of Export through Refinance**: The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

Supervisory Functions of RBI

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

1. **Granting license to banks**: The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.

2. **Bank Inspection**: The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.
3. **Control over NBFIs**: The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.
4. **Implementation of the Deposit Insurance Scheme**: The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

UNIT 3

MEANING AND CONCEPT OF CAPITAL MARKET

Capital Market is one of the significant aspects of every financial market. Hence it is necessary to study its correct meaning. Broadly speaking the capital market is a market for financial assets which have a long or indefinite maturity.

Unlike money market instruments the capital market intruments become mature for the period above one year. It is an institutional arrangement to borrow and lend money for a longer period of time. It consists of financial institutions like IDBI, ICICI, UTI, LIC, etc. These institutions play the role of lenders in the capital market. Business units and corporate are the borrowers in the capital market. Capital market involves various instruments which can be used for financial transactions.

Capital market provides long term debt and equity finance for the government and the corporate sector. Capital market can be classified into primary and secondary markets. The primary market is a market for new shares, where as in the secondary market the existing securities are traded. Capital market institutions provide rupee loans, foreign exchange loans, consultancy services and underwriting.

SIGNIFICANCE, FUNCTION OR IMPORTANCE OF CAPITAL MARKET

Like the money market capital market is also very important. It plays a significant role in the national economy. A developed, dynamic and vibrant capital market can immensely contribute for speedy economic growth and development.

Let us get acquainted with the important functions and role of the capital market.

1. **Mobilization of Savings** : Capital market is an important source for mobilizing idle savings from the economy. It mobilizes funds from people for further investments in the productive channels of an economy. In that sense it activate the ideal monetary resources and puts them in proper investments.
2. **Capital Formation** : Capital market helps in capital formation. Capital formation is net addition to the existing stock of capital in the economy. Through mobilization of ideal resources it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation.
3. **Provision of Investment Avenue** : Capital market raises resources for longer periods of time. Thus it provides an investment avenue for people who wish to invest resources for a long period of time. It provides suitable interest rate returns also to investors. Instruments such as bonds, equities, units of mutual funds, insurance policies, etc. definitely provides diverse investment avenue for the public.
4. **Speed up Economic Growth and Development** : Capital market enhances production and productivity in the national economy. As it makes funds available for long period of time, the financial requirements of business houses are met by the capital market. It helps in research and development. This helps in, increasing production and productivity in economy by generation of employment and development of infrastructure.
5. **Proper Regulation of Funds** : Capital markets not only helps in fund mobilization, but it also helps in proper allocation of these resources. It can have regulation over the resources so that it can direct funds in a qualitative manner.
6. **Service Provision** : As an important financial set up capital market provides various types of services. It includes long term and medium term loans to industry,

underwriting services, consultancy services, export finance, etc. These services help the manufacturing sector in a large spectrum.

7. **Continuous Availability of Funds** : Capital market is place where the investment avenue is continuously available for long term investment. This is a liquid market as it makes fund available on continues basis. Both buyers and seller can easily buy and sell securities as they are continuously available. Basically capital market transactions are related to the stock exchanges. Thus marketability in the capital market becomes easy.

CONCLUSION

The lack of an advanced and vibrant capital market can lead to underutilization of financial resources. The developed capital market also provides access to the foreign capital for domestic industry. Thus capital market definitely plays a constructive role in the over all development of an economy.

STOCK EXCHANGE

According to **Husband and Dockerary**, "Stock exchanges are privately organized markets which are used to facilitate trading in securities."

The Indian Securities Contracts (Regulation) Act of 1956, defines Stock Exchange as,
"An association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities."

Features of Stock Exchange

1. **Organized Market**

Stock exchange is an organized market. It deals with the securities such as shares, debentures and bonds. It provides common platform to the members of the exchange for carrying out transactions in securities. The transaction is carried out through the authorized broker or member of the stock exchange. It provides ready market to securities.

2. **Private Status**

Stock exchange is an association of persons. It is a privately owned association. Some of the stock exchanges are the joint stock companies, while some of them are association of persons. The stock exchange should be registered with the government.

3. **Government Control**

Stock exchange operates under the control of the government. Today SEBI has been controlling stock exchange in India. There are wide powers granted to SEBI by the government to regulate and control the stock exchange, particularly after securities scams.

4. **Rules & Regulations**

Stock exchange is an organized market which operated under well defined rules & regulations. Every stock exchange has it's own constitutions, bye-laws with managing body for orderly functioning of the exchange. The bye- laws contain detailed rules & regulations for carrying out securities transactions.

5. **Security Contracts**

Every transaction entered into by the parties in the stock exchange is a contract governed under the Securities Contracts (Regulation) Act, 1956. Therefore, the provision of the Securities Contract Act, have to be followed in day to day operations of the stock exchange.

6. **Nerve Center of Economy**

Stock exchange considered as a nerve center of the economy of any country. It is connected with the saving, investment and capital formation in the country. The country's economy is closely connected with the performance of the stock market.

7. **Sensitive**

Stock exchange are sensitive to the economic, political and social evens in the country as well as world events such as war, earthquake, flood, political charge, economic crisis affect the stock prices.

Functions of Stock Exchanges

The stock market occupies a pivotal position in the financial system. It performs several economic functions and renders invaluable services to the investors, companies, and to the economy as a whole. These are summarized as follows:

1. **Liquidity & Marketability of Securities**

Stock exchange provides liquidity to the securities since securities can be converted in to cash at any time according to the discretion of the investor by selling them at listed price. They facilitates buying and selling of the securities at listed price by providing continuous marketability to the investors in respect of securities they hold intended to hold. Thus, they create a ready outlet for dealing in securities.

2. **Safety of Funds**

Stock exchange ensures safety of funds invested because they have to function under strict rules and regulation and bye-laws are meant to ensure safety of investible funds. Overtrading, illegitimate speculations, etc. are prevented through carefully designed set of rules. This would strengthen the investor's confidence and promote large investment.

3. **Supply of Long Term Funds**

The securities traded in the stock market are negotiable and transferable in character and such as they can be transferred with minimum of formalities from one hand to another, but company is assured of long term availability of funds.

4. **Flow of Capital to Profitable Ventures**

The profitability and popularity of companies are reflected in stock prices. The price quoted indicates the relative profitability and performance of the companies and this facilitates the flow of capital in profitable channels.

5. **Reflection of Business Cycle**

The changing business conditions in the economy are immediately reflects through capital formation. But for these stock exchanges, surplus funds available with individuals and institutions would not have gone for productive and remunerative ventures.

6. **Speculations**

The stock exchange helps to make speculations in the market. Healthy speculations keep the exchange active. Normal speculations are not harmful but it provides more business to the exchanges. Therefore, stock exchanges encourage speculations in securities.

Importance of Stock Exchanges In Capital Market of India

Stock Exchanges play a crucial role in the consolidation of a national economy in general and in the development of industrial sector in particular. It is the most dynamic and organised component of capital market. Especially, in developing countries like India, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilisation of savings and ensuring investment safety.

1. Effective Mobilisation of savings

Stock exchanges provide organised market for an individual as well as institutional investors. They regulate the trading transactions with proper rules and regulations in order to ensure investor's protection. This helps to consolidate the confidence of investors and small savers. Thus, stock exchanges attract small savings especially of large number of investors in the capital market.

2. Promoting Capital formation

The funds mobilised through capital market are provided to the industries engaged in the production of various goods and services useful for the society. This leads to capital formation and development of national assets. The savings mobilised are channelised into appropriate avenues of investment.

3. Wider Avenues of investment

Stock exchanges provide a wider avenue for the investment to the people and organisations with investible surplus. Companies from diverse industries like Information Technology, Steel, Chemicals, Fuels and Petroleum, Cement, Fertilizers, etc. offer various kinds of equity and debt securities to the investors. Online trading facility has brought the stock exchange at the doorsteps of investors through computer network. Diverse type of securities is made available in the stock exchanges to suit the varying objectives and notions of different classes of investor. Necessary information from stock exchanges available from different sources guides the investors in the effective management of their investment portfolios.

4. Liquidity of investment

Stock exchanges provide liquidity of investment to the investors. Investors can sell out any of their investments in securities at any time during trading days and trading hours on stock exchanges. Thus, stock exchanges provide liquidity of investment. The on-line trading and online settlement of demat securities facilitates the investors to sellout their investments and realise the proceeds within a day or two. Even investors can switch over their investment from one security to another according to the changing scenario of capital market.

5. Investment priorities

Stock exchanges facilitate the investors to decide his investment priorities by providing him the basket of different kinds of securities of different industries and companies. He can sell stock of one company and buy a stock of another company through stock exchange whenever he wants. He can manage his investment portfolio to maximise his wealth.

6. Investment safety

Stock exchanges through their by-laws, Securities and Exchange Board of India (SEBI) guidelines, transparent procedures try to provide safety to the investment in industrial securities. Government has established the National Stock Exchange (NSE) and Over The Counter Exchange of India (OTCEI) for investors' safety. Exchange authorities try to curb speculative practices and minimise the risk for common investor to preserve his confidence.

7. Wide Marketability to Securities

Online price quoting system and online buying and selling facility have changed the nature and working of stock exchanges. Formerly, the dealings on stock exchanges were restricted to its head quarters. The investors across the country were absolutely in dark about the price fluctuations on stock exchanges due to the lack of information. But today due to Internet, on line quoting facility is available at the computers of investors. As a result, they can keep track of price fluctuations taking place on stock exchange every second during the working hours. Certain T.V. Channels like CNBC are fully devoted to stock market information and corporate news. Even other channels display the on line quoting of stocks. Thus, modern stock exchanges backed up by internet and information technology provide wide marketability to securities of the industries. Demat facility has revolutionised the procedure of transfer of securities and facilitated marketing.

8. Financial resources for public and private sectors
Stock Exchanges make available the financial resources available to the industries in public and private sector through various kinds of securities. Due to the assurance of liquidity, marketing support, investment safety assured through stock exchanges, the public issues of securities by these industries receive strong public response (resulting in oversubscription of issue).

9. Funds for Development Purpose
Stock exchanges enable the government to mobilise the funds for public utilities and public undertakings which take up the developmental activities like power projects, shipping, railways, telecommunication, dams & roads constructions, etc. Stock exchanges provide liquidity, marketability, price continuity and constant evaluation of government securities.

10. Indicator of Industrial Development
Stock exchanges are the symbolic indicators of industrial development of a nation. Productivity, efficiency, economic-status, prospects of each industry and every unit in an industry is reflected through the price fluctuation of industrial securities on stock exchanges. Stock exchange sensex and price fluctuations of securities of various companies tell the entire story of changes in industrial sector.

11. Barometer of National Economy
Stock exchange is taken as a Barometer of the economy of a country. Each economy is economically symbolized (indicators) by its most significant stock exchange. New York Stock Exchange, London Stock Exchange, Tokyo Stock Exchange and Bombay Stock Exchange are considered as barometers of U.S.A, United Kingdom, Japan and India respectively. At both national and international level these stock exchanges represent the progress and conditions of their economies.
Thus, stock exchange serves the nation in several ways through its diversified economic services which include imparting liquidity to investments, providing marketability, enabling evaluation and ensuring price continuity of securities.

CAPITAL MARKET INSTRUMENTS

A capital market is a market for securities (debt or equity), where business enterprises and government can raise long-term funds. It is defined as a market in which money is provided for periods longer than a year, as the raising of short-term funds takes place on other markets (e.g., the money market). The capital market is characterized by a large variety of financial instruments: equity and preference shares, fully convertible debentures (FCDs), non-convertible debentures (NCDs) and partly convertible debentures (PCDs) currently dominate the capital market, however new instruments are being introduced such as debentures bundled with warrants, participating preference shares, zero-coupon bonds, secured premium notes, etc

1. SECURED PREMIUM NOTES

SPN is a secured debenture redeemable at premium issued along with a detachable warrant, redeemable after a notice period, say four to seven years. The warrants attached to SPN gives the holder the right to apply and get allotted equity shares; provided the SPN is fully paid.

There is a lock-in period for SPN during which no interest will be paid for an invested amount. The SPN holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/ premium will be paid on redemption. In case the SPN holder holds it further, the holder will be repaid the principal amount along with the additional amount of interest/ premium on redemption in installments as decided by the company.

Ex-TISCO issued warrants for the first time in India in the year 1992 to raise 1212 crore.

2. DEEP DISCOUNT BONDS

A bond that sells at a significant discount from par value and has no coupon rate or lower coupon rate than the prevailing rates of fixed-income securities with a similar risk profile. They are designed to meet the long term funds requirements of the issuer and investors who are not looking for immediate return and can be sold with a long maturity of 25-30 years at a deep discount on the face value of debentures.

Ex-IDBI deep discount bonds for Rs 1 lac repayable after 25 years were sold at a discount price of Rs. 2,700

3. EQUITY SHARES WITH DETACHABLE WARRANTS

A warrant is a security issued by company entitling the holder to buy a given number of shares of stock at a stipulated price during a specified period. These warrants are separately registered with the stock exchanges and traded separately. Warrants are frequently attached to bonds or preferred stock as a sweetener, allowing the issuer to pay lower interest rates or dividends.

Ex-Essar Gujarat, Ranbaxy, Reliance issue this type of instrument.

4. FULLY CONVERTIBLE DEBENTURES WITH INTEREST

This is a debt instrument that is fully converted over a specified period into equity shares. The conversion can be in one or several phases. When the instrument is a pure debt instrument, interest is paid to the investor. After conversion, interest payments cease on the portion that is converted. If project finance is raised through an FCD issue, the investor can earn interest even when the project is under implementation. Once the project is operational, the investor can participate in the profits through share price appreciation and dividend payments

5. EQUIPREF

They are fully convertible cumulative preference shares. This instrument is divided into 2 parts namely Part A & Part B. Part A is convertible into equity shares automatically /compulsorily on date of allotment without any application by the allottee.

Part B is redeemed at par or converted into equity after a lock in period at the option of the investor, at a price 30% lower than the average market price.

6. SWEAT EQUITY SHARES

The phrase `sweat equity' refers to equity shares given to the company's employees on favorable terms, in recognition of their work. Sweat equity usually takes the form of giving options to employees to buy shares of the company, so they become part owners and participate in the profits, apart from earning salary. This gives a boost to the sentiments of employees and motivates them to work harder towards the goals of the company.

The Companies Act defines `sweat equity shares' as equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

7. TRACKING STOCKS

A tracking stock is a security issued by a parent company to track the results of one of its subsidiaries or lines of business; without having claim on the assets of the division or the parent company. It is also known as "designer stock". When a parent company issues a tracking stock, all revenues and expenses of the applicable division are separated from the parent company's financial statements and bound to the tracking stock. Oftentimes, this is done to separate a subsidiary's high-growth division from a larger parent company that is presenting losses. The parent company and its shareholders, however, still control the operations of the subsidiary.

Ex- QQQQ, which is an exchange-traded fund that mirrors the returns of the Nasdaq 100 index

8. DISASTER BONDS

Also known as Catastrophe or CAT Bonds, Disaster Bond is a high-yield debt instrument that is usually insurance linked and meant to raise money in case of a catastrophe. It has a special condition that states that if the issuer (insurance or Reinsurance Company) suffers a loss from a particular pre-defined catastrophe, then the issuer's obligation to pay interest and/or repay the principal is either deferred or completely forgiven.

Ex- Mexico sold $290 million in catastrophe bonds, becoming the first country to use a World Bank program that passes the cost of natural disasters to investors. Goldman Sachs Group Inc. and Swiss Reinsurance Co. managed the bond sale, which will pay investors unless an earthquake or hurricane triggers a transfer of the funds to the Mexican government.

9. MORTGAGE BACKED SECURITIES (MBS)

MBS is a type of asset-backed security, basically a debt obligation that represents a claim on the cash flows from mortgage loans, most commonly on residential property. Mortgage backed securities represent claims and derive their ultimate values from the principal and payments on the loans in the pool. These payments can be further broken down into different classes of securities, depending on the riskiness of different mortgages as they are classified under the MBS.

10. DERIVATIVES

A derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of some underlying asset typically commodity, bond, equity, currency, index, event etc. Advanced investors sometimes purchase or sell derivatives to manage the risk associated with the underlying security, to protect against fluctuations in value, or to profit from periods of inactivity or decline. Derivatives are often leveraged, such that a small movement in the underlying value can cause a large difference in the value of the derivative.

11. PARTICIPATORY NOTES

Also referred to as "P-Notes" Financial instruments used by investors or hedge funds that are not registered with the Securities and Exchange Board of India to invest in Indian securities. Indian-based brokerages buy India-based securities and then issue participatory notes to foreign investors. Any dividends or capital gains collected from the underlying securities go back to the investors. These are issued by FIIs to entities that want to invest in the Indian stock market but do not want to register themselves with the SEBI.

RBI, which had sought a ban on PNs, believes that it is tough to establish the beneficial ownership or the identity of ultimate investors.

12. HEDGE FUND

A hedge fund is an investment fund open to a limited range of investors that undertakes a wider range of investment and trading activities in both domestic and international markets, and that, in general, pays a performance fee to its investment manager. Every hedge fund has its own investment strategy that determines the type of investments and the methods of investment it undertakes. Hedge funds, as a class, invest in a broad range of investments including shares, debt and commodities.

As the name implies, hedge funds often seek to hedge some of the risks inherent in their investments using a variety of methods, with a goal to generate high returns through aggressive investment strategies, most notably short selling, leverage, program trading, swaps, arbitrage and derivatives.

Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they often require investors keep their money in the fund for at least one year.

13. FUND OF FUNDS

A "fund of funds" (FoF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in shares, bonds or other securities. This type of investing is often referred to as multi-manager investment. A fund of funds allows investors to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories that are all wrapped up into one fund.

14. GOLD ETF

A gold Exchange Traded Fund (ETF) is a financial instrument like a mutual fund whose value depends on the price of gold. In most cases, the price of one unit of a gold ETF approximately reflects the price of 1 gram of gold. As the price of gold rises, the price of the ETF is also expected to rise by the same amount. Gold exchange-traded funds are traded on the major stock exchanges including Zurich, Mumbai, London, Paris and New York There are also closed-end funds (CEF's) and exchange-traded notes (ETN's) that aim to track the gold price.

15. EXCHANGE TRADED FUNDS

An exchange-traded fund (or ETF) is an investment vehicle traded on stock exchanges, much like stocks. An ETF holds assets such as stocks or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day.
Most ETFs track an index, such as the S&P 500 or MSCI EAFE. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features, and single security can track the performance of a growing number of different index funds (currently the NSE Nifty)

Bombay Stock Exchange BSE

BSE is the leading and the oldest stock exchange in India as well as in Asia. It was established in 1887 with the formation of "The Native Share and Stock Brokers' Association". BSE is a very active stock exchange with highest number of listed securities in India. Nearly 70% to 80% of all transactions in the India are done alone in BSE. Companies traded on BSE were 3,049 by March, 2006. BSE is now a national stock exchange as the BSE has started allowing its members to set-up computer terminals outside the city of Mumbai (former Bombay). It is the only stock exchange in India which is given permanent recognition by the government. At present, (Since 1980) BSE is located in the "**Phiroze Jeejeebhoy Towers**" (28 storey building) located at Dalal Street, Fort, Mumbai. Pin code - 400021.

Objective of BSE

1. To safeguard the interest of investing public having dealings on the exchange.
2. To establish & promote honorable & just practices in securities' transaction.
3. To promote , develop & maintain well regulated market for dealing in securities.
4. To promote industrial development in the country through efficient souces.

Features of BSE

a) In march 1995, BSE introduced screen based trading called BOLT(BSE On Line Trading)
b) The BSE On-line Trading (BOLT): BSE On-line Trading (BOLT) facilitates on-line screen based trading in securities. BOLT is currently operating in 25,000 Trader Workstations located across over 359 cities in India.
c) It is designed to get best bids and offers from jobbars' book as well as the best buy & sell orders from the order book.
d) BOLT has a nation wide network.
e) Trading Work Station are connected with the main computer at Mumbai through WAN.
f) The capacity is 5,00,000 trades per day i.e. 6 hours from 9:30 A.M. to 3:30 P.M.
g) BSEWEBX.com**:** In February 2001, BSE introduced the world's first centralized exchange-based Internet trading system, BSEWEBX.com. This initiative enables investors anywhere in the world to trade on the BSE platform.
h) The BSE SENSEX, short form of Sensitive Index, first compiled in 1986 is a "market Capitalization-Weighted" index of 30 component stocks representing a sample of large, well-established and financially sound companies. The index is widely reported in both, the domestic international, print electronic media and is widely used to measure the used to measure the performance of the Indian stock markets.

National Stock Exchange NSE

Formation of National Stock Exchange of India Limited (NSE) in 1992 is one important development in the Indian capital market. The need was felt by the industry and investing community since 1991. The NSE is slowly becoming the leading stock exchange in terms of technology, systems and practices in due course of time. NSE is the largest and most modern stock exchange in India. In addition, it is the third largest exchange in the world next to two exchanges operating in the USA.

Features of NSE

a) The NSE boasts of screen based trading system. In the NSE, the available system provides complete market transparency of trading operations to both trading members and the participates and finds a suitable match. The NSE does not have trading floors as in conventional stock exchanges.
b) The trading is entirely screen based with automated order machine. The screen provides entire market information at the press of a button.
c) At the same time, the system provides for concealment of the identify of market operations. The screen gives all information which is dynamically updated.
d) As the market participants sit in their own offices, they have all the advantages of back office support, and facility to get in touch with their constituents.

INITIAL PUBLIC OFFERING (IPO)

Initial public offering (IPO), also referred to simply as a "public offering", is when a company issues common stock or shares to the public for the first time. They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies looking to become publicly traded.

In an IPO, the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market. Initial Public Offering (IPO) in India means the selling of the shares of a company, for the first time, to the public in the country's capital markets. This is done by giving to the public, shares that are either owned by the promoters of the company or by issuing new shares. During an Initial Public Offer (IPO) the shares are given to the public at a discount on the intrinsic value of the shares and this is the reason that the investors buy shares during the Initial Public Offering (IPO) in order to make profits for themselves.

Reason for listing IPOs:

a) **Increase in the capital**: An IPO allows a company to raise funds for utilizing in various corporate operational purposes like acquisitions, mergers, working capital, research and development, expanding plant and equipment and marketing.
b) **Liquidity**: The shares once traded have an assigned market value and can be resold. This is extremely helpful as the company provides the employees with stock incentive packages and the investors are provided with the option of trading their shares for a price.
c) **Valuation:** The public trading of the shares determines a value for the company and sets a standard. This works in favor of the company as it is helpful in case the company is looking for acquisition or merger. It also provides the share holders of the company with the present value of the shares.

Merits of IPO:

a) Low cost financing
b) No commitment of fixed returns.
c) No restrictions attached to financing.
d) No issues such as mortgaging, hypothecation etc.
e) Entire money received in one stroke without linking to any milestones.
f) No issues with returning of finance

Demerits

a) Success of IPO has an element of risk.
b) IPO can only finance part of the project
c) IPO performance post listing has also bearing.
d) For new promoters and new company it is difficult to market their IPO.

Book Building

Book Building is a process by which corporates determine the demand and the price of a proposed issue of securities through public bidding. The objective is to determine the quantum of the issue on the basis of the price book built. Once the price and the quantum of issue has been determined by the issuer, the issue may either be offered under the private placement of the public offer category, or both, as per the requirement of the SEBI regulations.

Characteristics:

a) Tendering Process
Book building involves inviting subscriptions to a public offer of securities, essentially through a tendering process. Eligible investors are required to place their bids for the number of shares to be issued and the price at which they are willing to invest, with the lead manager running the book. At the end of the cut off period, the lead manager determines the response to the issue in terms of the quantum of shares and the highest price at which demand is sufficient to match the size of the issue.

b) Floor Price:
Floor price is the minimum price set by the lead manager in consultation with the issuer. This is the price at which the issue is open for subscription. Investors are free to place a bid at any price higher than the floor price.

c) Price Band:
The range of price (the highest and the lowest price) at which offer for the subscription of securities is made is known as 'price band'. Investors are free to bid any price within in the price band.

d) Bid:
The investor can place a bid with the authorized lead manager merchant banker. In the case of equity shares, usually several brokers in the stock exchange are also authorized by the lead manager. The investor fills up a bid-cum-application form, which gives a choice to bid for up to three optional prices. The price and demand options submitted by the bidder are treated as optional demands and are not cumulated.

e) Allotment:
The lead manager, in consultation with the issuer, decides the price at which the issue will be subscribed and proceeds to allot shares to investors who have bid at or above

the fixed price. All investors are allotted shares at the same fixed price. For any allottee, therefore the price would be equal to or less than the price bid.

f) Participants:
Generally, all investors, including individuals, eligible to invest in a particular issue of securities can participate in the book building process. However, if the issue is restricted to qualified institutional, as in the case of government securities, then, only those eligible can participate.

The Process of book building:
The procedures relating to the book building process depend on the level at which it is to be taken up by a corporate entity. According to the SEBI, there are two options available to a company either 75 percent or 100 percent book building process. Each of these methods is discussed briefly below:

1. 75 percent Book Building:
The 75 percent book building option of securities is offered on a firm basis where a minimum of 25 percent of the securities is offered to the public.
The following steps are involved in this process:

2. **Eligibility:** All corporates eligible for public shares are also eligible for raising capital through the book building process.
4. **Earmarking securities:** Where a decision is taken by a corporate to issue shares through the book building process, the securities to be used should be separately earmarked as the placement portion category in the prospectus. The balance securities must be stated as net offer to the public category.
5. **Draft prospectus:** A draft prospectus containing all the information except price of the issue must be filed with the SEBI. Although no precise mention is made, a price band indicating the price range within which securities are being offered for subscription should be indicated. The prospectus is to be filed with the ROC within two days of the issue price being finalized.
6. **Appointment of book runner:** The issuing company appoints a merchant banker as the book runner, which mentioned in the prospectus. The book runner circulates a copy of the draft prospectus among the institutional buyers who are eligible for firm allotment and to the intermediaries who are eligible to act as underwriters, inviting them to subscribe to the issue of securities. The book runner maintains a record of the names and number of securities ordered by intermediary buyers and the price at which they are willing to subscribe the issue under the placement portion. The book runner collects information about the subscriptions received from underwriters and other intermediaries. After a stipulated time period, the book runner aggregates the subscription so received. The underwriters are required to make a payment of the total amount for the subscription of issues.

DEPOSITORY

A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered depository participant. It also provides services related to transactions in securities
At present two Depositories viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are registered with SEBI.

Advantages of Depository System

1. The risk associated with the physical certificates has been taken care off.
2. Initially the transfer of shares used to take a long time. For eg: 15 days or more in the present scenario the transfer is immediately debited or credited in the demat account hence it is faster and no loss of time.
3. The needs for maintaining the number of documents and paper work has been reduced with the introduction of demat system.
4. The cost of handling the paper work has been reduced and hence it has benefited the investors in paying less cost in terms of brokerage and other fees.
5. Exemption from stamp duty cost.
6. Faster payment on sale of shares.
7. There is a direct credit of non-cash benefits such as right shares bonus shares etc. including dividend.

DEMAT ACCOUNT

In India, shares and securities are held electronically in a Dematerialized (or "Demat") account, instead of the investor taking physical possession of certificates. A Dematerialized account is opened by the investor while registering with an investment broker (or sub-broker). The Dematerialized account number is quoted for all transactions to enable electronic settlements of trades to take place. Every shareholder will have a Dematerialized account for the purpose of transacting shares. Access to the Dematerialized account requires an internet password and a transaction password. Transfers or purchases of securities can then be initiated. Purchases and sales of securities on the Dematerialized account are automatically made once transactions are confirmed and completed.

Demat account benefits

The benefits of demat are enumerated as follows:

1. Easy and convenient way to hold securities
2. Immediate transfer of securities
3. No stamp duty on transfer of securities
4. Safer than paper-shares (earlier risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc. are mostly eliminated)
5. Reduced paperwork for transfer of securities
6. Reduced transaction cost
7. No "odd lot" problem: even one share can be sold
8. Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them separately.
9. Transmission of securities is done by DP, eliminating the need for notifying companies.
10. Automatic credit into demat account for shares arising out of bonus/split, consolidation/merger, etc.
11. A single demat account can hold investments in both equity and debt instruments.
12. Traders can work from anywhere (e.g. even from home).

Disadvantages of Demat

1. It is incumbent upon the capital market regulator to keep a close watch on the trading in dematerialized securities and see to it that trading does not act as a detriment to investors.
2. For dematerialized securities, the role of key market players such as stock-brokers needs to be supervised as they have the capability of manipulating the market.
3. Multiple regulatory frameworks have to be conformed to, including the Depositories Act, Regulations and the various Bye-Laws of various depositories.
4. Agreements are entered at various levels in the process of dematerialization. These may cause worries to the investor desirous of simplicity.
5. There is no provision to close a demat account, which is having illiquid shares. The investor cannot close the account and he and his successors have to go on paying the charges to the participant, like annual folio charges etc.
6. After liquidating the holdings, many Indian investors don't close their dp account.They are unaware that DPs charge even on

UNIT 4

MERCHANT BANKING

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy, to its clients, for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. It helps to expand and modernise the business. It helps in restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.

In short, merchant banking provides a wide range of services for starting until running a business. It acts as Financial Engineer for a business.

Merchant banking was first started in India in 1967 by Grindlays Bank. It has made rapid progress since 1970.

Definition

The Notification of the Ministry of Finance defines merchant banker as "Any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager-consultant, advisor or rendering corporate advisory services in relation to such issue management"

In the words of Skully "A Merchant Bank could be best defined as a financial institution conducting money market activities and lending, underwriting and financial advice, and investment services whose organization is characterized by a high proportion of professional staff able to able to approach problems in an innovative manner and to make and implement decisions rapidly."

Difference Between Commercial Banking & Merchant Banking:	
COMMERCIAL BANKING	**MERCHANT BANKING**
1. Deals with Debt & Debt related finance. 2. Asset oriented. 3. Generally avoid risks.	1. Deals with Equity & Equity related finance. 2. Management oriented. 3. Willing to accept risks.

Characteristics of Merchant Banking:

1. High proportion of decision makers as a percentage of total staff.
2. Quick decision process.
3. High density of information.
4. Intense contact with the environment.
5. Concentration of short and medium term engagements.
6. Emphasis on fee and commission income.
7. Innovative instead of repetitive operations.
8. Sophisticated services on a national and international level.
9. Low rate of profit distribution.
10. High liquidity ratio.

Qualities of merchant bankers:-

To be a successful merchant banker. Following qualities are necessary:

1. **Knowledge:** Thorough understanding of technical issues related to business, understanding of legal and statutory requirements, and appreciation of business acumen: financial expertise is a key thing a merchant banker must know. Delivery of his services depends on his basic understanding of these issues.
2. **Capital market familiarity:** Merchant banker should be 'veil versed with stock markets, their movements. He should track imp happenings in the market on ongoing basis.
3. **Liasioning ability:** Merchant bankers are required to liaison with SEBI1, RBI, the stock exchanges & other government authorities for public issue related duties. It is imperative that a merchant bank maintains excellent rapport with all of them and also close relations even at informal levels. This only can see speedy and favorable clearances by the authorities.
4. **Innovation:** Corporate may approach with unique requirements. Standard solutions and products may not solve problems sometimes. Merchant bankers should do out of box thinking and be able to do financial engineering. They can device new financial instruments and get approved from the authorities. Innovation is required even to address stringent legal requirements.
5. **Integrity:** Merchant banker has valuable and confidential information of its customers. Merchants bankers should take utmost care that the information is not leaked and also not consumed for the purpose other than for which it was disclosed to the merchant banker.

Functions of Merchant Banking

The important functions of merchant banking are depicted below.

The functions of merchant banking are listed as follows:

1. **Raising Finance for Clients**: Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.
2. **Broker in Stock Exchange:** Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual

Funds, Venture capital companies and Investment Banks offer merchant banking services.

3. **Project Management :** Merchant bankers help their clients in the many ways. For e.g. advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.
4. **Advice on Expansion and Modernization:** Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology upgradation, etc.
5. **Managing Public Issue of Companies:** Merchant bank advice and manage the public issue of companies. They provide following services:
   a) Advise on the timing of the public issue.
   b) Advise on the size and price of the issue.
   c) Acting as manager to the issue, and helping in accepting applications and allotment of securities.
   d) Help in appointing underwriters and brokers to the issue.
   e) Listing of shares on the stock exchange, etc.
6. **Handling Government Consent for Industrial Projects:** A businessman has to get government permission for starting of the project. Similarly, a company requires permission for expansion or modernization activities. For this, many formalities have to be completed. Merchant banks do all this work for their clients.
7. **Special Assitance to Small Companies and Entreprenuers**: Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available. It also helps them to take advantage of these opportunities, concessions, etc.
8. **Services to Public Sector Units**: Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.
9. **Revival of Sick Industrial Units:** Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package.
10. **Portfolio Management** : A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.
11. **Corporate Restructuring :** It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.
12. **Money Market Operation :** Merchant bankers deal with and underwrite short-term money market instruments, such as:
    a) Government Bonds.
    b) Certificate of deposit issued by banks and financila institutions.
    c) Commercial paper issued by large corporate firms.
    d) Treasury bills issued by the Government (Here in India by RBI).

13. **Leasing Services:** Merchant bankers also help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period. The lessor charges a fee called rentals.
14. **Management of Interest and Dividend:** Merchant bankers help their clients in the management of interest on debentures / loans, and dividend on shares. They also advise their client about the timing (interim / yearly) and rate of dividend.

Problems of Merchant Banking:

1) Restriction of merchant banking activities:
- SEBI guidelines have authorized merchant bankers to undertake issue related activities and made them restrict their activities or think of separating these activities from present one and float new subsidiary and enlarge the scope of its activities.

2) Minimum net worth of Rs.1 crore:
- SEBI guidelines stipulate that a minimum net worth of Rs.1 crore for authorization of merchant bankers.

3) Non co-operation of issuing companies:
- Non co-operation of the issuing companies in timely allotment of securities and refund of application money is another problem faced by merchant bankers.

4) Merchant Banker's Commission:
- Maximum :- 0.5%
- Project appraisal fees
- Lead Manager :-

In spite of problems popping up, merchant banking in India has vast scope to develop because of lot of domestic as well as foreign businesses booming here. Indian economy provides an amicable environment for these firms to set up, flourish and expand here.

Merchant Banking in India

Merchant banking activity was formally initiated into the Indian capital Markets when Grind lays bank received the license from reserve bank in 1967. Grind lays started with management of capital issues, recognized the needs of emerging class of entrepreneurs for diverse financial services ranging from production planning and system design to market research. Even it provides management consulting services to meet the requirements of small and medium sector rather than large sector. Citibank Setup its merchant banking division in 1970. The various tasks performed by this divisions namely assisting new entrepreneur, evaluating new projects, raising funds through borrowing and issuing equity. Indian banks Started banking Services as a part of multiple services they offer to their clients from 1972. State bank of India started the merchant banking division in 1972. In the Initial years the SBI's objective was to render corporate advice And Assistance to small and medium entrepreneurs. Merchant banking activities is OF course organized and undertaken in several forms. Commercial banks and foreign development finance institutions have organized them through formation divisions, nationalized banks have formed subsidiaries companies and share brokers and consultancies constituted themselves into public limited companies or registered themselves as private limited companies. Some merchant banking outfits have entered into collaboration with merchant bankers abroad with several branches.

UNIT 5

Mutual fund

A mutual fund is a trust that pools the savings of several investors and then in vests these into different kinds of securities (shares, debentures, money market instruments, or a combination of these) in keeping with a pre-stated investment objective.

Definition

"Mutual Fund is a collective fund that belongs to and made available by those interested investors who opt for (choose) a Systematic Investment Plan (SIP)."

Structure of mutual fund

In India, the following entities are involved in a mutual fund operation;

1. The sponsor
2. The mutual fund
3. The trustees
4. The asset management company
5. The custodian
6. The registrars &Transfer agents

1. **The sponsor;** The sponsor of a mutual fund is like the promoter of a company. The sponsor may be a bank, a financial institution, or a financial services company. It may be Indian or foreign. For example the sponsor of Templeton Mutual Fund is Templeton international Inc. the sponsor has to obtain a license from SEBI for which it has to satisfy several conditions relating to capital, profits, track record, default free dealings and so on.
   The sponsor is responsible for setting up and establishing the mutual fund. The sponsor is the settler of the mutual fund trust. The sponsor delegates the trustee function to the trustee.
2. **Mutual fund;**
   The mutual fund is constituted as a trust under the Indian Trust Act, 1881. and registered with SEBI. The beneficiaries of the trust are the investors who invest in various schemes of the mutual fund.
3. **Trustees:** a trust is a notional entity that cannot contract in its own name. so, the trust enters into contracts in the names of the trustees. Appointed by the sponsor, the trustees can be either individuals or a corporate body. To ensure that the trustees are fair and impartial, SEBI rules mandate that at least two-thirds of the trustees are independent this means that they have association with the sponsor.
   Trustees appoint the asset management company, secure necessary approvals, periodically monitor how AMC functions and hold the properties of the various schemes In trust for the benefit of the investors. Trustees can be held accountable for the financial irregularities of the mutual fund.
4. **Asset Management Company**
   Asset Management Company also referred to as the investment manager, is a separate company appointed by the trustees to run the mutual fund. For example, Templeton Asset Management Private Ltd., is the AMC of the Templeton Mutual Fund. The AMC should have a certificate from SEBI to act as portfolio manager under the SEBI rules and regulations, 1993. The AMC handles all operational matters such as designing the schemes, launching the schemes, managing investments and interacting with investors.

In return for its services the AMC is compensated in the form of investment management and advisory fees. Each scheme of the mutual fund pays the AMC an annual investment management and advisory fees which is linked to the size of the scheme

5. **Custodian**
   The custodian handles the investment back office operations of a mutual fund. Inter alia, it looks after the receipt and delivery of securities, collection of income, distribution of dividends, and segregation of assets between schemes. The sponsor of a mutual fund cannot act as its custodian. This condition is meant to ensure that the assets of the mutual fund are not in the hands of its sponsor.
6. **Registrars and transfer agents**.
   The registrars and transfer agents handle investor related services such as issuing units, redeeming units, sending fact sheets and annual reports and so on. Some funds handle such functions in house, while others outsource it to SEBI approved registrars and transfer agents like Karvy and CAMS.

Types of mutual funds:

1. Types of mutual funds by structure
2. Types of mutual funds by nature
3. Types of mutual funds by investment objective

1. Types of mutual funds by structure

1) **Close ended fund/scheme:** A close ended fund or scheme has a predetermined maturity period (eg. 5-7 years). The fund is open for subscription during the launch of the scheme for a specified period of time. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units on the stock exchanges where they are listed. In order to provide an exit route to the investors, some close ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices or they are listed in secondary market.
2) **Open ended fund/scheme:** The most common type of mutual fund available for investment is an open-ended mutual fund. Investors can choose to invest or transact in these schemes as per their convenience. In an open-ended mutual fund, there is no limit to the number of investors, shares, or overall size of the fund, unless the fund manager decides to close the fund to new investors in order to keep it manageable. The value or share price of an open-ended mutual fund is determined at the market close every day and is called the Net Asset Value (NAV).
3) **Interval schemes:** Interval schemes combine the features of open-ended and close-ended schemes. The units may be traded on the stock exchange or may be open for sale or redemption during pre-determined intervals at NAV related prices. FMPs or Fixed maturity plans are examples of these types of schemes.

2. Types of mutual funds by nature

1) **Equity mutual funds:** These funds invest maximum part of their corpus into equity holdings. The structure of the fund may vary for different schemes and the fund manager's outlook on different stocks. The Equity funds are sub-classified depending upon their investment objective, as follows:
   a) Diversified equity funds
   b) Mid-cap funds
   c) Small cap funds

d) Sector specific funds
e) Tax savings funds

Equity investments rank high on the risk-return grid and hence, are ideal for a longer time frame.

2) **Debt mutual funds:** These funds invest in debt instruments to ensure low risk and provide a stable income to the investors. Government authorities, private companies, banks and financial institutions are some of the major issuers of debt papers. Debt funds can be further classified as:
   a) Gilt funds
   b) Income funds
   c) Short term plans
   d) Liquid funds
3) **Balanced funds:** They invest in both equities and fixed income securities which are in line with pre-defined investment objective of the scheme. The equity portion provides growth while debt provides stability in returns. This way, investors get to taste the best of both worlds.

3. Types of mutual funds by investment objective

1) Growth schemes

Also known as equity schemes, these schemes aim at providing capital appreciation over medium to long term. These schemes normally invest a major portion of their fund in equities and are willing to withstand short-term decline in value for possible future appreciation.

2) Income schemes

Also known as debt schemes, they generally invest in fixed income securities such as bonds and corporate debentures. These schemes aim at providing regular and steady income to investors. However, capital appreciation in such schemes may be limited.

3) Index schemes

These schemes attempt to reproduce the performance of a particular index such as the BSE Sensex or the NSE 50. Their portfolios will consist of only those stocks that constitute the index. The percentage of each stock to the total holding will be identical to the stocks index weight age. And hence, the returns from such schemes would be more or less equivalent to those of the Index.

4. Other types:

1) Fund of Funds

A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FoF scheme. An FoF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.

2) Load Fund

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses.

Suppose the NAV per unit is Rs.10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay Rs.10 and those who offer their units for repurchase to the mutual fund will get only Rs.9.90 per unit.

3) No load fund

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.

4) **Real estate mutual funds**
The REMF scheme is a mutual fund scheme with the investment objective of direct or indirect investment in real estate property.

Net Asset Value:
The Mutual Fund Net Asset Value or NAV is the total market value of all the assets, including cash, held by the fund, after deducting its liabilities. The per unit NAV represents the market value of one unit of the mutual fund. It is the price at which investors can buy or redeem the mutual fund's units. The NAV is calculated by dividing the total value of all the assets of the mutual fund, less any liabilities, by the number of units outstanding.

Advantages of Mutual Funds Investments

Merits or advantages of mutual funds investments are depicted below.

The **benefits** or advantages of mutual funds are listed and linked as follows:

1. Simple to invest.
2. Professionally managed.
3. Offers diversification.
4. Conveniently administered.
5. Gives higher returns.
6. Low cost management.
7. Offers liquidity.
8. Provides transparency.
9. Highly regulated.
10. Allows to switch to other schemes.

Now let's briefly discuss each advantage of mutual fund one by one.

1. **Simple to invest**

Investment in mutual fund is simple as compared to other available investments in the market. The minimum investment required is pretty less.

SIP (Systematic Investment Plan) can start with a contribution of say just $10 (approx. INR 500) on a monthly basis. Furthermore, most of the schemes of the mutual fund have an automatic reinvestment plans.

2. **Professionally managed**

Mutual fund is managed by skilled and professionally experienced managers with a backup of a research team. The fund manager helps to channel the funds in the best available growth opportunities.

Investors purchase mutual fund because they do not have a time or the expertise to manage their own portfolio. A mutual fund helps to resolve such issues of the investors.

3. **Offers diversification**

The mutual fund offers diversification in a portfolio which reduces the risk of fall in a value of investments.

Purchasing units in a mutual fund is a best option, instead of buying individual stocks or bonds. The investment risk is spread out and minimized up to a certain extent.
The basic idea behind diversification is to invest in a large number of assets so that a loss in any particular investment is minimized by gains in other investments.

4. **Conveniently administered**

In mutual fund, there is no administrative risk of share transfer, as many of the mutual funds offer these services in their Demat trading accounts, which finally save investor's time.
These proper and prompt services help the investor to grab the available growth opportunities.

5. **Gives higher returns**

Investor usually gets higher returns in mutual fund as compared to other avenues of investment.
There are various schemes of mutual fund offered by, **HDFC** mutual fund, **SBI** mutual fund, **ICICI** mutual fund, **Franklin Templeton** mutual fund, etc. where they have provided excellent returns.
However, investors have to be cautioned that such high returns are not to be taken as consistent and regular returns.

6. **Low cost management**

As per the policy of the various statutory authorities, the organizations operating the mutual fund can only shift certain prescribed percentage of cost on the investors. The extra cost incurred such as management expenses, etc. has to be borne by the organization.
An operating cost of mutual fund is considered to be relatively less expensive. Since, mutual fund buys and sells large amounts (quantity) of securities at a time, this helps in reducing transaction costs.
Thus, mutual fund assures low cost management.

7. **Offers liquidity**

The mutual fund can be easily liquidated as per the request of the investors. Just like an individual stock, mutual fund also allows investors to liquidate their holdings as and when they required.

8. **Provides transparency**

The statutory authorities have compelled all the mutual fund companies to disclose their **Net Assets Value** (NAV). The NAVs are calculated on daily basis and published through the available media. Mutual Fund companies disclose their financial statements to their investors and to others.

9. **Highly regulated**

Mutual funds all over the world are highly regulated. The mutual fund manager has to submit all necessary documents to the statutory authorities for their approval, to make investment in the required securities.

10. **Allows to switch to other schemes**

Mutual fund gives an option to an investor, to switch to other schemes whenever they like, without any charges. This helps the investor to take benefit of the various available schemes which will finally help the investor to maximize his or her returns.

Disadvantages of Mutual Funds

The seven prominent disadvantages of mutual funds are depicted below.
The main **limitations** or disadvantages of mutual funds are listed as follows:

1. Mutual funds are subject to market risk

Mutual fund investments are subject to market risk involved. This caution (warning) can be checked with the offer document where it is clearly mentioned as follows:

"MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS. PLEASE READ THE OFFER DOCUMENT CAREFULLY BEFORE INVESTING."

2. No guarantee of returns

Mutual funds do not give any guarantee of the returns for the investments made in the various schemes of the mutual fund.

3. Diversification of portfolio doesn't maximize returns

Mutual fund helps to diversify the portfolio. However, though the diversification of portfolio helps in minimization of risk, these do not results in maximization of returns to the investors.

4. Selecting right financial securities is not easy

It's not an easy task for the fund manager to select the appropriate and suitable financial securities to invest the available funds for generating higher returns.

5. Cost management not proportional to performance

Mutual fund managers are one of the highest-paid executives in the finance domain. Furthermore, the fee paid to the **Asset Management Company** (AMC) is no way related to the performance of the mutual fund.

6. Unethical practices may creep in

Mutual fund managers may follow unethical (corrupt) practices to boost the performance of the various schemes of mutual funds.

7. 12b-1 fees of mutual funds

Hidden fees are popularly known as **12b-1 fees**. It is basically a sum of annual distribution fees or marketing fees. The 12b-1 fee derives its name from a section in the Investment Company Act of 1940, United States.
12b-1 fees are disclosed in the mutual fund prospectus and can also be found on the official website of such issuer organization.

Conclusion on Mutual Funds

The prime motive of mutual fund is to give access to small investors to invest in the stocks, bonds, shares and other securities. Otherwise, this would have been impossible for them to invest in such financial securities with limited available funds with them.
Furthermore, mutual funds are professionally managed to mitigate the probability of risk, to a certain extent.