



FINANCIAL MARKETS AND SERVICES

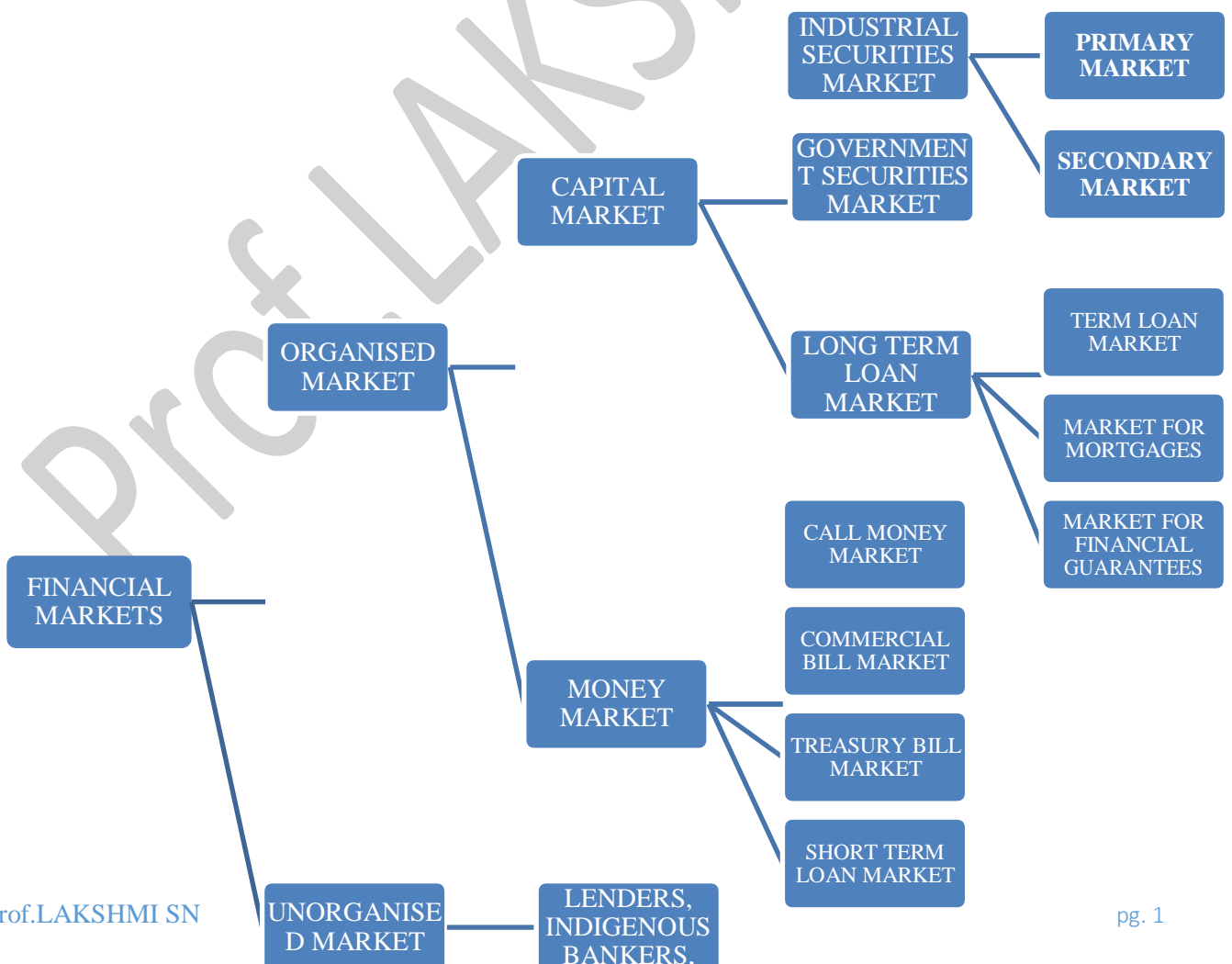
CHAPTER 1

FINANCIAL MARKETS

MEANING OF FINANCIAL MARKETS

A financial market refers to the institutional arrangement for dealing in financial assets and credit instruments of different types, such as currency cheques, bank deposit bills, etc.

CLASSIFICATION OF FINANCIAL MARKETS



UNORGANISED MARKET

Unorganised market consists of money lenders, indigenous bankers, and 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. Their activities are not controlled by RBI. Efforts were made by RBI but were not successful. The regulations regarding their financial dealings are still inadequate and their financial instruments have not been standardized.

ORGANISED MARKET

In the organised market, there are standardized rules and regulations governing their financial dealings. There is high degree of institutionalisation and instrumentalisation. These markets are subject to strict supervision & are controlled by the RBI or other regulatory bodies. These organised markets can be classified into two. They are:

1. Capital Market
2. MoneyMarket

1. CAPITALMARKET

This is a market for financial assets which have a long or indefinite maturity. Generally, it deals with long term securities of above one year maturity period. The Capital market is further divided into three

- A. Industrial Securitiesmarket
 - B. Government Securitiesmarket
 - C. Long-term loansmarket
- A. Industrial SecuritiesMarket

It is a market for industrial securities like equity shares or ordinary shares, preference shares and debentures or bonds. It is a market where companies raise their capital or debt by issuing appropriate instruments. Industrial Securities Market is further sub-divided into two. Theyare:

- i. Primary Market or New issuemarket
- ii. Secondary Market or Stockexchange

i. PrimaryMarket

Primary market is a market for new issues or new financial claims. Hence, the name New issue market. It deals with those securities which are issued to the public for the 1st time. Borrowers issue/exchange new financial securities for long-term funds in this market. This facilitates capital formation. There are mainly three ways to raise capital. They are:

- Publicissue
- Rightsissue
- Private placement

ii. SecondaryMarket

It is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded here. It consists of stock exchanges recognised by the Government of India. Generally, securities quoted in the Stock Exchange provide continuous and regular market for buying and selling of securities.

B. Government Securitiesmarket

This market is also called Gilt-edged securities market. It is a market where government securities are traded. There are long term & short term Government Securities. Long Term securities are traded in this market whereas Short Term in the money market. Securities issues by the Central Government, State Governments, Semi-government authorities like city corporations, port trusts etc, state electricity boards, all India and State level financial institutions and public sector enterprises are dealt in this market. Government Securities are issued in denominations of Rs. 100. Interest is payable half-yearly and they carry a taxexemption.

Major participants in this market are the commercial banks because they hold a great portion of these securities to meet their SLR requirements. Government Securities are sold through the Public Debt Office of the RBI while Treasury bills are sold through auctions. The Government Securities are in many forms. These aregenerally:

- Stock certificates or inscribedstock

- Promissory notes
- Bearer bonds which can be discounted.

C. Long-term loan market

Development banks and commercial banks play a significant role in this market by supplying LT loans to corporate. This market can be further classified as:

1. Term Loan market
2. Mortgage market
3. Financial guarantee market

2. MONEY MARKET

It is a market dealing with financial assets and securities which have a maturity period of up to one year. It is a market for Short term funds. They are subdivided into four:

- A. Call Money Market
- B. Commercial Bills Market
- C. Treasury Bills Market
- D. Short-Term Loan Market

IMPORTANCE OF CAPITAL MARKET

- It serves as a vital source for the productive use of the economy's savings.
- Provides incentives to saving and facilitates capital formation by offering suitable rates of interest as the price of capital
- Provides an avenue for investors
- Facilitates increase in production and productivity in the economy and hence enhances the economic welfare of the society.

FOREIGN EXCHANGE MARKET

It refers to the process of converting home currencies into foreign currencies and *vice-versa*. The market where foreign exchange transactions take place is called a foreign exchange market. There is no physical space that exists in a foreign exchange market. This market works 24/7 and is controlled by the Foreign Exchange Maintenance Act (FEMA).

PRIMARY MARKET (NEW ISSUE MARKET)

New issue market represents the primary market where new securities i.e., shares or bonds that have never been previously issued, are offered. The new issue market encompasses all institutions dealing in fresh claim. These claims may be in the form of equity shares, preference shares/ debentures, rights issue, deposits etc. All financial institutions which contribute, underwrite and directly subscribe to the securities are part of new issue market.

FEATURES OF PRIMARY MARKET

- 1) Primary market deals with new securities which are being issued to the public for the firsttime.
- 2) It is the market in which both newly established companies and existing companies can raise capital by offering their securities to thepublic
- 3) The primary market provides the issuing company with necessary funds for starting a new enterprise or for their expansion, diversification or modernization of an existing unit.
- 4) Primary market facilitates the transfer of funds from the suppliers (investors) to the companies raising freshcapital.
- 5) The investors buy securities directly from the companies issuing newsecurities.
- 6) The borrowers exchange the newly created securities for long term funds in the primarymarket.
- 7) All financial institutions which contribute, underwrite and directly subscribe to the securities are part of the new issue market or the primarymarket.
- 8) The new issue market channelizes the savings of the individuals and others into long term investments which helps in the economic growth and industrial development of a country.

- 9) The securities which are dealt in new issue market are transferable and marketable. The investors who invest money in the new issue market can receive it back by way of selling these securities in the stockmarket.
- 10) The primary market is regulated and controlled by the Securities and Exchange Board of India (SEBI). It offers transparency and discipline on the dealings in the primary market.

FUNCTIONS OF NEW ISSUE MARKET/ PRIMARY MARKET

The main function of a new issue market is to facilitate transfer of resources from savers to users. The savers are individuals, commercial banks, insurance companies, etc. the users are public limited companies and government. The new issue market plays an important role of mobilising the funds from the savers and transferring them to borrowers for productive purposes, an important factor for economic growth. It is not only a platform for raising finance to establish new enterprises but also for expansion/ diversification/ modernisation of existing units. On this basis, the new issue market can be classified as:

1. Market where firms go to the public for the 1st time through IPO
2. Market where firms which are already trading raise additional capital through Seasoned Equity Offering (SEO)

The main functions of a new issue market can be divided into triple service functions:

1. Origination
2. Underwriting
3. Distribution

1. ORIGINATION

It refers to the work of investigation, analysis & processing of new project proposals. It starts before an issue is actually floated in the market.

There are two aspects to the origination process:

- a) Careful study of technical, economic & financial viability to ensure soundness of the project.
 - Preliminary investigation is undertaken by the sponsors.

b) Advisory services which improve the quality of capital issue and ensure its success

– Advisory services include

- Type of issue
- Magnitude of issue
- Time of floating an issue
- Pricing of an issue
- Technique of selling the securities

The function of origination is done by a merchant banker.

2. UNDERWRITING

It is an agreement whereby the underwriter promises to subscribe to a specified no. of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue.

Methods of Underwriting

- Standing behind the issue – Under this method, the underwriter guarantees the sale of a specified number of shares within a specified period. If the public do not subscribe to the specified amount of issue, the underwriter buys the balance in the issue.
- Outright purchase – The underwriter in this method, makes an outright purchase of shares and resells them to the investors.
- Consortium method – underwriting is jointly done by a group of underwriters in this method. The underwriters form a syndicate for this purpose. This method is adopted for large issues.

Advantages of underwriting

- The issuing company is relieved from the risk of finding buyers for the issue offered to the public i.e., the company is assured of raising adequate capital

- The company is assured of getting the min. subscription within the stipulated time, a statutory obligation
- Underwriters undertake the burden of highly specialised function of distributing securities.
- Provide expert advice with regard to timing of security issue, the pricing of issue, the size & time of securities to the issue, etc.
- Public confidence on the issue is enhanced when underwriting is done by reputed underwriters
- Underwriters in India may be classified into 2 categories:
 1. Institutional underwriters
 - Examples are LIC, UTI, IDBI, ICICI, Commercial banks & general insurance companies
 2. Non- Institutional underwriters
 - Examples are brokers who view to earning commission

3. DISTRIBUTION

Distribution is the Function of sale of securities to ultimate investors. This service is performed by brokers and agents who maintain a regular and direct contact with the ultimate investors.

METHODS OF FLOATING NEW ISSUES

1. Public issues

Under this method, the issuing company directly offers to the general public/institutions a fixed number of shares at a stated price through a document called prospectus. It is the most common method adopted by Joint Stock Companies to raise capital

Prospectus must contain the following:

- Name of the company

- Address of the registered office of the company
- Existing & proposed activities
- Location of the company
- Names of directors
- Authorised and proposed issue capital to the public
- Dates of opening & closing the subscription
- Minimum subscription
- Names of brokers/underwriters/merchant bankers/managers and registrar to the issue
- A statement by the company that it will apply to stock exchange for quotations of its shares

Merits of Public issue/through prospectus

1. Sale through prospectus has the advantage of inviting a large section of the investing public through advertisement
2. Direct method and no intermediaries are involved
3. Shares are allotted to a large section of investors on a non-discriminatory basis

Demerits

1. It is an expensive method
2. This method is suitable only for large issues.

2. Offer for Sale

The method of offer for sale consists of outright sale of securities through the intermediaries of issue houses or share brokers. In other words, the shares are not offered to the public directly.

- This consists of two steps:
 - Direct sale by the issuing company to the issue house and brokers at an agreed and negotiated price.
 - The intermediaries resell the above securities to the ultimate investors at a higher price.

The difference in the purchase and sale price is called turn or spread. This method is otherwise called Bought Out Deals (BOD)

Advantage

- Enables an issuer with good project to obtain funds with minimum cost without fear of under-subscription.
- Company is relieved from the problem of printing and advertisement of prospectus and making allotment of shares

3. Placement

Under this method, the issue houses or brokers buy the securities outright with the intention of placing them with their clients afterwards. Here, the brokers act as almost wholesalers selling them in retail to the public. The brokers would make profit in the process of reselling to the public. The issue houses or brokers maintain their own list of clients and through customer contact sell the securities. There is no need for a formal prospectus as well as underwriting agreement

Advantages of placement

- Timing of the issue is important for successful floatation of shares. In depressed market conditions, when the issues are not likely to get public response through prospectus, placement method is useful
- Suitable for small companies
- Avoids delays involved in public issue and also expenses involved

Disadvantages

- The securities are not widely distributed to the large section of investors. A selected group of small investors are able to buy a large no of shares and get majority holding in acompany

4. Rights Issue

Rights issue is a method of raising funds in the market by an existing company. A right means an option to buy certain securities at a certain privileged price within a certain specified period. Shares, so offered to the existing shareholders are called rights shares. These shares are offered to the existing shareholders in a particular proportion to their existing share ownership. The ratio depends on the requirement of capital. The rights themselves are transferable and saleable in the market

Advantages

- Cost of issue is minimum as there is no underwriting, brokerage, advertising and printing of prospectus expenses.
- Ensures equitable distribution of shares to all existing shareholders so the control of company remains undisturbed
- Prevents directors from issuing new shares in their own name or their relatives at a lower price and get controlling right

PLAYERS IN THE PRIMARY MARKET

There are many players in the new issue market. The important of them are the following:

1. Merchant Bankers: They are the issue managers, lead managers, co- managers and are responsible to the company and SEBI.
2. Registrars to the Issue: Registrars are an important category of intermediaries who undertake all activities connected with new issue management. They are appointed by the company in consultation with the merchant bankers, in respect of servicing of investors.

The role of Registrar in the pre issue, during the currency of the issue, pre- allotment, allotment and post allotment are described below:

Role of Registrar in Pre- Issue

- i) Suggest draft application form to the merchant bankers.
- ii) Help in identifying the collection centre. The choice of collection centre and of collecting banker is critical to the success of the issue.
- iii) Assist in opening collection accounts with banks and lay down procedure for operation of these accounts.
- iv) Send instructions to collecting branches, for collection of application along with cheques, drafts, stock invest separately and remittance offunds.
- v) Workout modalities to receive the collection figures on a regular basis until the subscription list are closed.

During the currency of Issue

- i) Receive the collection figures everyday
- ii) Tabulate and classify the collection data on the basis of the standard proforma of slabs of shares applied for.
- iii) Keep the merchant bankers and the company informed of the progress of total subscriptions
- iv) Inform the stock exchange about the closure of issue.

Pre- Allotment Work

- i) Get all application forms from the collecting bankers and sort out valid and invalid application forms.
- ii) The valid applications are to be categorized and grouped as cash, draft and stock invest applications.
- iii) Reclassify the valid applications eligible for allotment.
- iv) Prepare the list with inverted numbers and then approach the regional stock exchange for finalizing the basis of allotment, in the event of over subscription.
- v) Finalize the allotment as per the basis approved by the stock exchange.
- vi) Tally the final list approved for allotment and rejections with the in-house control numbers and correct mistakes, if any.

Allotment Work

The most important work of a Registrar is allotment of shares. The system of proportional allotment was adopted for new issues in 1993. A new quota system was approved by SEBI in April, 1995. According to the new system 50% of quota is for small investors and another 50% for other categories. The small investors include all applicants' up to 1000 shares. It has been revised recently.

Post Allotment Work

- i) Get the letters of allotment and refund orders printed ready for dispatch. They have to be mailed on or before 70 days from the closing date of subscription. For any delay, get the permission of the Registrar of companies and the relevant regional stockexchange.
- ii) Submit all statements to the company for their final approval.
- iii) Arrange to pay the brokerage and underwriting commission and submit their relevant statements.
- iv) Assist the company in getting the allotted shares listed on the stockexchange.

Qualifications for Registrars to the Issue

To be appointed as Registrar to the issue, registration with SEBI is essential. The criteria adopted by SEBI for registration are the competency and expertise, quality of manpower, their track record, adequacy of infrastructure such as computers, storage space, etc., and capital adequacy. A net worth of Rs. 6 Lakhs is essential for registrars. SEBI has laid down a code of conduct for their observance.

3. Collection and Co-coordinating Bankers:

Collecting bankers collect the subscriptions in cash, cheques, and stock invest. etc.

Co-ordinating bankers collect information on subscriptions and co-ordinate the collection work. They monitor the work and inform it to the registrars and merchant bankers.

4. Underwriters and Brokers: Underwriters promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue.

Brokers along with the network of sub workers market the new issues. They send their own circulars and applications to the clients and do follow up work to market the securities.

5. Printers, advertising agencies and mailing agencies are other organizations involved in the new issue market operations.
6. Individual Investors: Individuals prefer to make investments in such securities which provide them better security of investment i.e., minimum risk, stable returns, liquidity, capital approach and growth, lesser tax burden etc.,

The investors are classified into 3 categories. They are:-

- i) Real Investors: They are the individuals who have surplus of income or past accumulated wealth and which they wish to invest for making future. Such investors who are not affiliated with the issuing company either as existing shareholders or as creditors or customers of the company, etc., are termed as real investors.
 - ii) Speculative investors: They are certain investors who purchase securities with speculative motives. They aim is to sell securities and make capital gains through wide fluctuations in the value of securities.
 - iii) Individuals affiliated with the issuing company: The existing companies usually prefer to sell their fresh issues to its customers, employees, creditors and existing shareholders etc.
7. Joint Stock companies: The joint stock companies are the next important group of investors in corporate securities.
 8. Institutional Investors: The various institutional investors are private institutional investors – UTI, LIC's, commercial banks etc., Public financial institutions – IDBI, ICICI etc., & foreign institutional investors.

INSTRUMENTS IN PRIMARY MARKET

1. Secured Premium Notes with Detachable Warrants (SPN):

SPN are issued along with detachable warrant. The warrants attached to it ensure the holder the right to apply and get equity shares after a notified period provided the SPN is fully paid up.

The SPN is issued at a nominal value and does not carry any interest.

The SPN is redeemed by repayment in several instalments at a premium over the face value. The premium amt is distributed equally over the period of maturity of the instrument.

2. Equity Shares with Detachable Warrants:

In this instrument, along with fully paid up equity shares detachable warrants are issued which entitle the warrant holder to apply for a specified number of shares at a determined price.

Detachable warrants are registered separately with the stock exchange and traded separately.

3. Preference shares with warrants:

This instrument shall carry a certain number of warrants entitling the holder to apply for equity shares at premium at any time in one or more stages between the third and fifth year from the date of allotment.

4. Non convertible debentures with detachable equity warrants:

The holder of the instrument is given an option to buy a specified number of shares from the company at a predetermined price with a definite timeframe.

There is a specific lock in period after which the holder can exercise his option to apply for equity shares.

5. Fully convertible cumulative preference share: This instrument has 2 parts, A & B

- Part –A is convertible into equity shares automatically on the date of allotment without application by the allottee,
- Part –B will be redeemed at par/converted into equity after a lock in period, at the option of the investors.

6. Zero Interest fully convertible debentures (FCDs):

- No interest will be paid to the holders of this instrument till the lock in period. After a notified period this debenture will be automatically and compulsorily converted into shares.

7. Fully Convertible Debentures (FCDs) with interest:

- This instrument carries no interest for a specified period. After this period, option is given to apply for equities at premium for which no additional amount is payable.
- However, interest on FCDs is payable at a determined rate from the date of first conversion to second/ final conversion and equity will be issued in lieu of interest amount.

8. Zero Interest Bonds: It is sold at a discount from their eventual maturity value and bears no interest. In India, zero interest convertible bonds are issued by companies. These bonds do not carry any interest till the date of conversion and are converted into equity shares at par or premium on the expiry of a fixed period.

9. Deep Discount Bonds: These bonds are sold at large discount to their nominal value. There are no interest payments on these bonds and the investors get return as accretion to the par value of the instruments over its life.

10. Option Bonds: It may be cumulative or non – cumulative as per the option of the holder of the bonds.

- In case of cumulative bonds, interest is accumulated and is payable on maturity only.
- In case of non – cumulative bonds, the interest is paid periodically. The option is to be exercised by the investor at the time of investment.

11. Equity shares: There are also known as ordinary shares/common shares representing the owners in a company. The holders of these shares are the real owners of the company. Equity shareholders take more risk and their dividends are paid only after preference shareholders' dividends are paid.

12. Preference Shares: These shareholders are being given the preferential rights on the payment of dividends. Whenever a company distribute a profit, the dividend is first paid on preference capital.
13. Deferred Shares: These shares were earlier issued to promoters or founders for services rendered to the company. These shares were known as founders shares because they were normally issued to founders.
14. No par stock /shares: No par stock shares having no face value. The capital of a company issuing such shares is divided into a number of specified shares without any specific denominations. The share certificate of the company simply states the number of shares held by its owner without mentioning any facevalue.
15. Sweat Equity: The shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know- how or making available rights in the nature of intellectual property rights. The purpose of sweat equity is to ensure more loyalty and participation of employees.

PROCEDURE FOR ISSUING EQUITY AND DEBENTURES

The following steps are followed before a company goes for the issue of shares and debentures:

1. Preliminary Investigation and Analysis: The sponsors of issue undertake a preliminary study of the technical, economic and financial viability of the new project/enterprise to ensure the success of the new issue.
 - a) Types of Issue: This refers to the type of securities to be issued whether equity share, preference share, debenture or convertible debenture by the new or existing company issues by new companies are called as Initial issue or Initial Public Offering and those by existing companies are called further issue.
 - b) Magnitude of Issue: How many numbers of shares will be issued and in what proportion is decided in advance by the issuer companies. Companies now allot certain portion of the offering to different segments so that everyone gets a chance to participate.

- c) Terms of Issue: Whether shares are to be issued at par or at a premium or at a discount are decided by the issuer company. The terms on which shares are to be issued by the company are given in the prospectus.
 - d) Time of floating an Issue: At what time the issue should be floated in the market has to be decided carefully as stock market conditions directly influence the primary market.
 - e) Methods of Issue: How the capital is to be raised from the market whether by issue of prospectus, or by making an offer for sale to the issue house or stock brokers or by private placement or through issue of Rights shares or bonus shares is an important issue to be taken care of by the issuer companies.
 - f) The techniques of selling of securities: The success of new issues depends on the response of the investing public. It calls for the choice of exact method of marketing shares and debentures,
2. Propaganda or Advertisement: After the type of issue, size of issue, time and terms of issue have been decided, the prospectus of the new issue are highlighted to the investors by giving an advertisement in a leading newspaper along with some important extracts of the prospectus.
 3. Underwriting: Companies do get their shares underwritten in order to ensure success of the issue. Underwriting is an agreement whereby underwriter agrees to take up specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue.
 4. Application for Shares: An investor when satisfied with the profitability and other things has to fill up the application form and deposit the same along with the requisite amount with the prescribed scheduled bank. The scheduled bank will send this application money along with the list of applicants to the company.
 5. Allotment of shares: After receiving the applications the directors take steps to allot these shares. Allotment of share means acceptance of the offer of the applicant for the purchase of shares. A company cannot allot more than shares offered to the public for subscription through the prospectus.

SEBI GUIDELINES TOWARDS ISSUE OF EQUITY SHARES

The important aspects of SEBI Guidelines, with reference to issue of equity shares are as under:

1. Abridged prospectus has to be attached with every application
2. A company has to highlight the risk factors in the prospectus
3. Objective of the issue and cost of project should be mentioned in the prospectus
4. Company's management past history and present business of the firm should be highlighted in the prospectus.
5. Particulars in regard to company and other listed companies under the same management which made any capital issues during the last three years are to be stated in the prospectus.
6. Justification for premium, in case of premium is to be stated
7. Subscription list for public issues should be kept open for a minimum of three days and a maximum of 10 working days
8. The collection centre should be at least 30 which include all centres with stock exchanges.
9. Collection agents are not to collect application money in cash,
10. The quantum of issue whether through a right or public issue, shall not exceed the amount specified in the prospectus. No retention of over subscription is permissible under any circumstances.
11. A compliance report in the prescribed form should be submitted to SEBI within 45 days from the date of closure of issue.
12. Minimum number of shares per application has been fixed at 500 shares of face value of Rs.100
13. The allotment has to be made in multiples of tradable lot of 100 shares of Rs.10 each.
14. Issues by way of bonus, rights etc to be made in appropriate lots to minimize odd lots.
15. If minimum subscription of 90% has not been received, the entire amount is to be refunded to investors within 120 days
16. The capital issue should be fully paid up within 120 days
17. Underwriting has been made mandatory
18. Limit of listing of companies issue in the stock exchange has been increased from Rs.3 crores to Rs. 5 crores

19. The gap between the closure dates of various issues viz., rights and public should not exceed 30 days
20. Issues should make adequate disclosure regarding the terms and conditions of redemption, security conversion and other relevant features of the new instrument so that an investor can make reasonable determination of risks, returns, safety and liquidity of the instrument. The disclosure will be vetted by SEBI in this regard.

SEBI GUIDELINES FOR DEBENTURES

- 1) The amount of working capital debenture should not exceed 20% of the gross current assets.
- 2) The debt equity ratio should not exceed 2:1
- 3) The rate of interest can be decided by the company
- 4) Credit rating is compulsory for all debentures excepting debentures issued by public sector companies, private placement of non convertible debentures with financial institutions and banks.
- 5) Debentures are to be redeemed after the expiry of seven years from the date of allotment. NCD is permitted to be redeemed at 5% premium.
- 6) Normally debentures above seven years cannot be issued.
- 7) Debentures issued to public have to be secured and registered
- 8) A debenture redemption reserve is to be set up out of profits of the company
- 9) Debenture trustee and debenture trust deed are to be finalized within six months of the public offer.

ADVANTAGES OF PRIMARY MARKET

- i) **Avenue for investment:** A primary market provides good avenues for investments in financial assets which are more productive than physical assets. Most of the investors, particularly the household sector prefers this avenue since it is convenient and more profitable
- ii) **Mobilization of savings:** A well developed primary market offers adequate incentives in the form of interest or dividend that may allure investors from all walks of the society to invest savings in the primary market.

- iii) Channelizing savings for productive use: The primary market helps to mobilise the small and scattered saving and augments the availability of investible funds. These funds are utilized for productive purposes and thus, the wastage in unproductive uses is avoided.
- iv) Source of large supply of funds: The rapid development of any country required the growth of large scale industries which need huge capital. The huge amount of funds required for these industries cannot be provided by few persons. But huge money can be raised in a primary market by floating new shares in the market.
- v) Rapid Industrial Growth: The primary market facilitates increase in production and productivity in the economy by means of establishing many new companies and thereby promoting rapid industrial growth in a country.
- vi) Source for expansions and technological upgradation: The primary market also serves as an important source for raising money for expansion of industries as well as for technological upgradation.

DISADVANTAGES OF PRIMARY MARKET

- i) Possibility for deceiving investors
- ii) No fixed norms for project appraisal
- iii) Lack of post issue seriousness
- iv) Ineffective role of merchant bankers
- v) Delay in allotment process
- vi) Poor mobilization of savings etc.,

SECONDARY MARKET/ STOCK MARKET

Meaning: Stock market represents the secondary market where existing securities (shares and debentures) are traded; stock exchange provides an organized mechanism for purchase and sale of existing securities.

Stock exchanges are organized and regulated markets for various securities issued by corporate sector and other institutions.

Definition of stock exchange: According to Pyle “security exchanges are market places where securities that have been listed thereon may be bought and sold for either investment or speculation.”

According to the Securities Contracts (Regulation) Act 1956

Stock exchange means anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

According to this Act, securities include the following:

- Shares, scripts, stocks, bonds, debentures, stock or other marketable securities of any incorporated company or corporate
- Government securities
- Right or interest securities

ROLE AND IMPORTANCE OF STOCK EXCHANGE

- The stock exchange will play an important role in the success of the economy of the country.
- The stock exchange is one of the basic financial tools for stimulating the economy by attracting capital for investment in the projects.
- The stock exchange also helps to revive other sectors of the economy such as commerce, industry and service.
- Shares, scrips, stocks, debentures stock and government securities are traded in stock exchange.
- Stock exchanges are provided appropriate advice to their clients.

- Stock exchange will list public, private and foreign companies.
- Stock exchange wish to join the linkage system between the region's stock exchanges and at a later stage, with international stock exchanges.
- Stock exchange is providing a market that mobilises and distributes the nation's savings utilised for the best purpose of the country.
- Stock exchange is a market in which securities are bought and sold.

Control over secondary market:

For the effective functioning of secondary market, proper control must be exercised. At present, control is exercised through the following three important processes:-

- 1) Recognition of Stock Exchange
- 2) Listing of Securities
- 3) Registration of brokers

1) Recognition of Stock Exchange:-

Stock exchanges are the important ingredient of capital market. They are the citadel of capital and fortress of finance. They are the theatres of trading in securities and as such they assist and control the buying and selling of securities.

Recognition Procedure

The stock exchange in India have to be recognized by the central govt. under securities contracts regulation act and SEBI and they have to comply with the provisions of the SCRA and SEBI and also the bye laws and regulations duly approved by the govt.

Any stock exchange which needs recognition under SEBI Act has to submit an application in the prescribed manner to the central govt. This application must be accompanied by the following documents:-

- i) A copy of the bye-laws of the stock exchange for its operation
- ii) A copy of the rules relating to its constitution, governing body, powers and duties of the office bearers, the admission procedure etc.,

Grant of Recognition

The following conditions must be fulfilled

- i) The rules and bye - laws of the stock exchange applying for registration must ensure fair dealing and protect the interest of investors
- ii) The stock exchange concerned must be willing to comply with any other conditions that may be imposed by the govt., from time to time
- iii) The grant of recognition must be in the interest of trade as well as in the public interest.

Renewal of recognition

If any stock exchanges intend to renew its recognition, it must once again make an application to the central govt., in the aforesaid manner three months before expiry of the period of recognition.

Withdrawal of Recognition

The central govt., may withdraw the recognition if the grant is against the interest of trade or public interest.

ORGANISATION STRUCTURE

The organisation structure of stock exchanges is different from place to place.

Different forms are:

- Voluntary non-profit making association - 3 Stock Exchanges
- Public Limited Company - 14 Stock Exchanges
- Company Limited by Guarantee - 6 Stock Exchanges.

Mumbai, Ahmedabad and Indore are three recognized Stock Exchanges. These are the voluntary non-profit making associations. Kolkata, Delhi, Bangalore, Cochin, Kanpur, Ludhiana, Guwahati Stock Exchanges are the examples of Public Limited Company/Joint Stock Companies Limited by Shares. Hyderabad, Mumbai and Pune Stock Exchanges are the examples of the Companies Limited by Guarantee.

Listing of Securities

Listing of securities means the securities are admission for trading on a recognized stock exchange. In the case of securities are not listed in the stock exchange such company securities are not trading n the stock exchange. Listing is compulsory for a public issuing company that intends to offer shares/debentures to the public for subscription. Listed securities are of two classes, viz., cash List and Forward List. The securities on the cash list are those involving ready delivery while securities in the forward list enjoy forward trading privileges.

Listing has some advantages

- Listing of securities provides the marketability and liquidity of thesecurities
- Listing protects the interest of both shareholders and the investingpublic
- Listing encourages investment and flow of savings into the capitalmarket
- Listing offers wide publicity to the concernedcompanies
- Listing provides buying and selling of securities in the stockexchange
- Listing promotes better corporate practices and lead to progressively higher standards of corporate procedures andpractices
- Listing enjoys higher public confidence as the stock exchange compels the issuer to comply with highstandards

Disadvantages

- Listed securities offers wide scope for the speculators to manipulate the values in such a way as detrimental to the interest of thecompany
- Sometime listed securities are subject to wide fluctuations in their value. The wide fluctuations in their values have the effect of degrading the company's reputation and images in the eyes of the public as well as the financialintermediaries
- Listing discloses vital information such as operating environment tocompetitors

TRADING IN SECURITIES

The trading in securities is governed by the Rules and Bye laws of the Stock Exchange.

Meaning of Securities

According to the Securities Contracts (Regulation) Act 1956, Section 2(h) defines the key word "Securities". Securities includes shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate. Securities also cover government securities and rights or interests in securities. But it does not include securities of private companies as they are not capable of being dealt in on a stock exchange and are not marketable securities due to possible restrictions on transfer. The major instruments in securities trading are debentures, public sector bonds and government securities.

Issue of securities are as outlined below:

- Government Securities
- Corporate Securities
- Corporate Debentures
- Company Deposits
- Commercial Paper
- Fixed Deposits
- Equity Shares
- Preference Shares
- Bonds

Registration of Stock Brokers

Stock Broker

- An agent that charges a fee or commission for executing buy and sell orders submitted by an investor

- The firm that acts as an agent for a customer, charging the customer a commission for its service
- A stock broker is someone who performs transactions on the stock market on behalf of third parties who are unable or unwilling to trade themselves
- Stock broker who is a member of the stock exchange to deal securities on recognised stock exchanges, the broker should register his name as a broker with the SEBI. A stock broker should possess the following qualifications to register as a broker.
 - He should be an Indian Citizen within 21 years of age
 - He should not be bankrupt or compounded with creditors
 - He should not have been convicted for any offence, fraud etc.
 - He should not have engaged in any other business other than that of a broker in securities
 - He should not be defaulter of any stock exchange
 - He should have completed 12th Standard examination.

Duties/Code of Conduct for Stock Brokers

- A stock broker should be honest and promptly execute all orders regarding upon buying and selling of securities.
- He should make prompt payment to his clients in the case of sales and prompt delivery in the case of purchases.
- He should not differentiate between small investors and big investors.
- He should issue a contract note for all transactions as specified by the stock exchange without any delay.
- He should maintain complete secrecy of his client's personal investment and other information of a confidential nature.
- He should not influence purchases or sales just for the sake of his brokerage or commission.
- He should not give any false and misleading information to his clients particularly as relating to sales and purchases of securities.
- He should not entertain those clients who have failed to carry out their commitments in respect of securities with other stock brokers.

- He should act as duly informed to his client.
- He should have adequate infrastructure facilities and maintain proper staff to render prompt, efficient and fair service to his clients
- He should not advertise his business publicly except when it is permitted by the stock exchange.
- He should not adopt unfair practices with a view to attracting clients from other brokers.
- He should not fail to submit the necessary returns to the SEBI

Registration of Sub- Brokers

A sub-broker is not a member of a stock exchange. Therefore, he is a person who acts as an agent of a stock broker. He undertakes the securities trading business on behalf of his clients by through stock brokers. Sub-brokers should also get a certificate of registration from SEBI. Just like as brokers, they have to satisfy the eligibility criteria, pay registration fees and follow the code of conduct and the various rules and regulations framed by the regulating authorities from time to time. In this case excepting the registration fees, other aspects are more or less similar to brokers.

Types/Kinds of Brokers

Brokers may be classified as below:

- ✓ Jobbers
- ✓ Commission Broker
- ✓ Tarawaniwalas
- ✓ Sub-brokers/Remisers
- ✓ Floor Broker
- ✓ Odd Lot Dealer
- ✓ Budliwala
- ✓ Arbitrageur
- ✓ Dealers in Non-cleared Securities
- ✓ Security Dealer
- ✓ Authorized Clerk

Jobbers

A Jobber is a professional and independent broker who deals in securities on his behalf. It means, he purchases and sells securities in his own name. His main job objective is to earn a margin of profit due to price variations of securities. Jobbers are a professional broker who carefully judges the value of the securities and makes a good forecast of their future price movements. He buys securities as a owner, keeps them for a very short period and sells them for profit known as the Jobber's turn .A Jobber will always quote a two-way price called double-barreled price. The lower price indicates that the jobber is ready to purchase and higher price indicate that the jobber is ready to sell the securities.

Commission Brokers

A commission broker is nothing but a broker. He buys and sells securities for earning a commission on behalf of the clients. He is permitted to deal with non-members directly. His main function is to buy and sell securities on behalf of his client and earning commission. He does not purchase or sell in his name.

Tarawaniwalas

A Tarawaniwala is an active member in the stock exchange. He is similar to as Jobber. Tarawaniwalas act as a broker and as well as a jobber. He is not prohibited from acting as a broker. This system has a demerit that a tarawaniwala can act against the interest of investors by purchasing securities from them in his own name at lower prices and selling the same securities to them at higher prices.

Sub-broker

As stated earlier, a sub-broker is an agent of a stock broker. He helps the clients to buy and sell securities only through the stock broker.

Floor Broker

Floor brokers are not found on Indian Stock Exchanges. The floor broker buys and sells shares for other brokers on the floor of exchange. The floor brokers are not officially attached to other members. The floor broker executes orders for any members and receives as his compensation a share of brokerage charged by the commission.

Odd Lot Dealer

The odd lot dealer specializes in buying and selling in amount less than the prescribed trading units or lots. He buys odd lots and makes them up to marketing trading units or lots. He engaged in round lot transactions. The price of the odd lot is determined by the round lot transactions. He earns high profit on the difference between the price at which he buys and sells the securities. He does not rely on commission

Buddiwala

Buddiwala is a financier in the stock exchange. He is also known as Budliwalla. He is giving credit facilities to the market. And he charges a fee which called as 'Contango' or 'Backwardation' charge. He gives a secured loan that for a short period of two to three weeks. The return is governed by technical position of the market and ruling the rate of interest.

Arbitrageur

Arbitrageur is a specialist in buying and selling in securities in different markets at the same time and profits by the difference in the price between the two stock exchanges.

Dealers in Non-cleared Securities

He is a specialist in buying and selling on his own account shares which are not in the active list.

Security Dealer

He is a specialist in buying and selling the Government or Gilt Edge securities.

Authorized Clerks

An authorised clerk is one who is appointed by a stock broker to assist him in the business of securities trading. As per the rules of the stock exchange, each broker can employ a specified number of authorized clerks to transact the securities trading business

FUNCTIONS OF SECONDARY MARKET

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

Kind/Types of Transaction in a Stock Exchange

The Stock Exchanges are permitted to the members on behalf of his client to enter into transactions in securities as outlined:-

Spot Delivery: Means for delivery and payment on the same day.

Hand Delivery: Means for delivery and payment with the time, which shall not more than 14 days

Special Delivery: For delivery and payment within any time exceeding 14 days following the date of contract as may be stipulated when entering into the bargain and permitted by the governing board.

Badla Transaction

Badla transaction/carry over refers to the postponement of the settlement of transaction till the next settlement period. It is a facility to carry forward the transaction from one settlement period to another. If the buyers/sellers wish to carry forward their transactions from

settlement period to the next settlement period, they draw up a fresh set of contract notes to give effect to the carry forward of the purchase/sale at rates which reflect the badla charges.

Badla Charges

Badla charges are fixed on the basis of demand and supply conditions in the market and they are fixed on a fortnightly basis. Therefore, the Badla charges could vary in different settlement periods. The carry forward charges or interest is to be paid by the buyer or seller in each scrip sold. Badla charges or the amount of interest charges is also known as VyajBadla.

Factors Influencing Badla Rates

The Badla charges or the amount of interest charges which are contracted to be paid as a result of carry forward the transaction from one settlement period to another are based on several factors as outlines below:•

- The total amount of badla finance available in the market
- The speculative business position in the market
- Availability of badla finance for a particular scrip (scrip means speculative transaction)
- The present interest rates in the money market
- The psychological state of the market.

Speculation on the Stock Exchange

Speculation transactions are made with the intention of making profits by disposing of securities at favourable prices. Speculative transactions does not involve full payment for and taking delivery of the securities which the speculators have contracted to transfer. Speculators do not take/give delivery of shares. They deal in differences in the purchase and sale prices. Their main intention is to carry forward the transactions and get short term gains due to price differences.

Kinds/Types of Speculators

Speculators of the stock exchanges may be classified into the three.:-

Bull: A Bull is also known as Tejiwalla, Bulls are very optimistic of the rise in prices of securities. He is a speculator who buys shares in the expectation of selling it at a higher price later. Thus, in a bull market there will be excess of purchases over sales.

Bear: A bear is also known as Mandiwalla. Bears are very pessimistic and always they expect a fall in the prices of securities in future. Hence, bear goes on selling securities. Therefore, a bearish market refers to a falling market and there will be excess sales over purchases.

Stag: A stag neither buys nor sells but applies for subscription to the new issues expecting that he can sell them at a premium. Generally, Stag buys new issues and sell them on allotments or even before allotment for a profit.

SPECULATIVE TRANSACTION

Option Dealing

Option is the right to buy or sell a certain quantity of security at a certain price within a certain time. The option to buy is known as call option or Teji Sauda and the option to sell is known as Put Option/Mandi Sauda. The Put and Call is a double option (known as Teji Mandi) giving right either to purchase or to sell securities. In option dealing, a speculator is given the right or option to buy or sell, or both buy and sell as the case may be on the settlement day or else he will forfeit the option money.

Wash Sales

It is a technique through which a speculator is able to earn huge profits by creating a misleading picture in the market. It is of fictitious transaction in which a speculator sells and buys security at a higher price through another broker. However, it creates a false or misleading opinion in the market about the price of the security in question. As a result of misleading, the price records a further rise and the speculator is able to get high profits by selling the securities to the public. It is purely in the interest of speculators.

Arbitrage

Arbitrage is a highly skilled speculative activity. Arbitrage is a device to make profit out of the differences in prices of a security in two different markets. Arbitrages refers to carry of a security from one market to another, it is also described as traffic in securities. Such a traffic may be carried on between two markets within the country is known as domestic arbitrage. A traffic may be carried on between two markets with one country to another country is known as Foreign Arbitrage.

Cornering

Cornering refers to the process of holding the entire supply securities by an individual or a group of individuals in terms to the short seller and earning more profits. In this case, the short sellers (i.e., bears) who have contracted to sell the security without actually possessing it would be unable to deliver it to the buyers, who have cornered the market. It is also a prohibited activity.

Rigging the Market

Rigging is the process to create an artificial condition in the market. This impact is the price fluctuation of the securities in the market. Speculators main intention is earning of huge profit from the speculation

Blank Transfers

Blank transfer helps to speculative activities by through carry-over/ badla transactions. The transferor (seller) signs the transfer form without specifying the name of the transferee (buyer) as known as blank transfer. Badla/carryover transactions are involves temporary purchases and sales of securities.

Blank transfer is an undesirable activity due to the following reasons:

- In the case of partly paid up capital, the seller's liability is continues even after he actually sold it. It is not justifiable.
- Blank transferee escapes from the payment of stamp duty and transfer fees etc. which is the loss of revenue to the government.
- In the case of blank transfer, the transferee's name is not disclosed. Therefore, he can evade income tax.

- Blank transferees to gain control of the management of companies without disclosing their names.
- The blank transferee's name will not be recorded in the register of companies. Therefore, the registers are incomplete and misleading information to perspective investors.
- Registered shares are made freely negotiable through blank transfers. However, it encourages unhealthy speculation.

Margin Trading

Margin Trading is a popular method of Speculative Trading. In this method, the client opens an account with his broker. Client makes deposit of cash or securities in his account. Client has agreed to maintain a minimum margin of amount deposit always in his account. When, broker purchases securities on behalf of his client his account will be debited and vice versa

TRADING AND SETTLEMENT SYSTEM OF STOCK EXCHANGE TRANSACTIONS

TRADING PROCEDURE IN A STOCK EXCHANGE

The stock exchange operations at floor level are highly technical in nature. Non-members are not permitted to enter into the stock market. Hence, various stages have to be completed in executing a transaction at a stock exchange. The steps involved in the method of trading are as follows:

1. Selection of a broker:

The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator.

2. Opening Demat Account with Depository:

Demat (Dematerialized) account refers to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (e.g. Shares, Debentures, Bonds, Mutual (Funds, etc.) At present in India there are two depositories: NSDL (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.) There is no direct contact between depository and investor. Depository interacts with investors through depository participants only.

Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

3. Placing the Order:

After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.

Investor must place the order very clearly specifying the range of price at which securities can be bought or sold. e.g. "Buy 100 equity shares of Reliance for not more than Rs 500 per share."

The orders may take any one of the following forms:

- a) At best order: It is an order which does not specify any specific price. It must be executed immediately at the best possible price. The client may also fix a time-frame within which the order has to be executed.

Ex: 'Buy 100 Essar Oil shares at Best'

- b) Limit order: It is an order for the purchase or sale of securities at a fixed price specified by the client.

Ex: 'Sell 100 DCM at Rs.76'

- c) Immediate or cancel order: It is an order for the purchase or sale of securities immediately at the quoted prices. If the order could not be executed at the quoted prices immediately, it should be treated as cancelled.

Ex: 'Buy 100 shares of Infosys at Rs. 700 immediate'

- d) Discretionary order: It is an order to buy or sell shares at whatever price the broker thinks reasonable. This is possible only when the client has complete faith on the broker.
- e) Limited Discretionary order: It is an order to buy or sell securities within a specified price range and/or within the given time period as per the best judgement of the broker.
- f) Open order: It is an order to buy or sell without fixing any time limit or price limit on the execution of the order. It is similar to discretionary order.
- g) Stop loss order: It is an order to sell as soon as the price falls up to a particular level or to buy when the price rises up to a specified level. This is mainly to protect the clients against a heavy fall or rise in prices so that they may not suffer more than the pre-specified amount.

4. Execution of orders

As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

5. Settlement of Transactions

The settlement is made by means of delivering the share certificates along with the transfer deed. The transfer deed is duly signed by the transferor, i.e., the seller. It bears the stamp of the selling broker. The buyer then fills up the particulars in the transfer deed. At present, the settlement can be made by any one of the following methods:

a) **On the spot settlement:**

It means settlement is done immediately and on spot settlement follows T + 2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday.

b) Forward settlement:

It means settlement will take place on some future date. It can be T + 5 or T + 7, etc. All trading in stock exchanges takes place between 9.55 am and 3.30 pm from Monday to Friday.

At present India follows the T+2 or rolling settlement system. Rolling settlement is a system to settle share transactions in predefined number of days. It is a mechanism of settling trades done on a stock exchange on the Day of Trade (T) plus "X" trading days. "X" trading days could be any number of days like 1,2,3,4 or 5 days. So, if we say the rolling settlement for a transaction is T+3 then it means that the transaction will be settled in TODAY + Next 3 Days. In other words, in T+3 environments, a trade done on T day is settled on the 3rd working day excluding the Tday.

At NSE and BSE, trades in rolling settlement are settled on a T+2 basis i.e. on the 2nd working day. Saturdays and Sundays are excluded because the stock exchanges remain closed on weekends.

PLAYERS IN THE STOCKMARKET

The key players in the stock market are:

1. Stock exchanges – they act as a facilitator for trading
2. SEBI – acts as a regulator in the market
3. Depositories - Depository is an institution which maintains an account for investors' securities (share, debentures, mutual fund etc) in a dematerialized or an electronic form and the exchanges of securities takes place.
4. Dealers - An individual or entity, such as a securities firm, who it acts as a principal and stands ready to buy and sell for its own account. More generally, an individual or entity which buys and sells products and holds an inventory
5. Broker - An individual or firm who acts as an intermediary between a buyer and seller, and usually charges a commission for securities and most other products. Broker requires a license to function.

6. Retail investor - An individual who purchases small amounts of securities for him/herself, as opposed to an institutional investor. They are also called individual investors or small investors.
7. Domestic institutional investors like mutual funds, insurance companies, pension funds, banks, financial institutions etc
8. Foreign Institutional Investors (FIIs) - A hedge fund, pension fund manager, mutual fund, bank, insurance company, large corporate buyer, or a representative agent for any of these parties that is registered to do business in a country other than where the investment instrument is being purchased. The investor takes positions in foreign financial markets on behalf of the institution in the home country.
9. Speculators - A person who makes risky investments, anticipating a major change in the future price of the asset.
10. Arbitrageurs - A trader who uses arbitrage strategies to take advantage of price disparities between the same security, currency, or commodity in two different markets.

MERITS OF STOCK MARKET

- Stock market is an Economic Barometer of the country.
- Stock Market provides continuous and ready market for securities.
- Stock Market ensures transparency in dealing through proper regulation mechanism.
- Stock Market contributes to the Economic growth in the country
- It allows for spreading of Equity culture
- It provides scope for speculation
- Stock Market provides liquidity to the existing investment
- It facilitates better allocation of capital
- Promotes the habits of savings and investment

DEMERITS OF STOCK MARKET

- Companies listed in the stock market may become vulnerable to market fluctuations beyond control – including market sentiments, economic conditions or developments in the sector.
- Companies listed in the stock market become more responsible to shareholders which may divert them from their own objectives
- Extreme downturn in the stock market may result in erosion of investment of small and retail investor
- Stock market may become vulnerable to scams as happened in the past
- Excessive speculation in the stock market may be dangerous

NATIONAL STOCK EXCHANGE (NSE)

The National Stock Exchange of India (NSEI) was established in 1994 to encourage stock exchange reform through system modernization and competition. It is an electronic screen based system where members have equal access and equal opportunity of business irrespective of their location in different parts of the country as they are connected through a satellite network.

The National Stock Exchange is to operate in two segments as outlined below

- Wholesale Debt Market: Wholesale Debt Market is concerned with trading instruments such as Gilt edge securities, commercial papers, PSU Bonds, units, and certificate of Deposits.
- Capital Market: The Capital Market is concerned with equity and corporate debt instruments.

OBJECTIVES OF NATIONAL STOCK EXCHANGE

The NSE objectives as outlined below:

- It establishes nationwide trading facility for equity debt and hybrid.
- It facilitates equal access to investors across the country.
- It provides fairness, efficiency and transparency to the securities trading.
- It enables shorter settlement cycles.
- It meets international securities market standard.

FEATURES OF NSE

- It set up a fully automated screen based trading system
- It has consists of three segments: The capital market segment, wholesale debt market segment and derivatives market
- It market is a fully automated screen based environment

- It owns satellite network by through market operates with all participants stationed at their office and making use of their computer terminals, to receive market information, to enter orders and execute to trade.
- The NSE has opted for an order driven system. This system provides enormous flexibility to trading members. A trading member can place various conditions on the order in terms of price, time or size when an order is placed by a trading member; an order confirmation slip is generated. All orders received are staked in price and time priority. The computer system automatically reaches for a match and no sooner to the same is found the deal is struck.
- When a trade takes place, a trade confirmation slip is printed at the trading member's work station.
- It pending orders is delayed, the identity of the trading is not revealed to others
- On the eighth day of trading, each member get a statement showing his net position as the clearing house of the securities.
- Members are required to deliver securities and cash by the thirteenth and fourteenth day respectively, the fifteenth day is the payout day.
- It automated trade matching system secures the best prices available in the market to the investor

OVER THE COUNTER OF EXCHANGE OF INDIA

Meaning

Over the counter market is a market where buyers seek out sellers' and vice versa and then attempt to arrange terms and conditions for purchase/sale acceptable to both parties. In OTC refers trading take place by putting buy and sell orders by telephone, telex, letter, oral message, etc. There is no particular market place in the geographical area.

OTCEI- ORIGIN

The OTCEI was incorporated in 1990 as a company under the Companies Act 1956. It became fully operational on September 1992, with opening of a counter in Bombay. The OTCEI is recognised by the Government of India as a recognized Stock Exchange under Section 4 of the Securities Control Regulation Act, 1956

BASIC OBJECTIVES OF OTC

- Quicker liquidity
- Fixed and Fair Price
- Liquidity for a less trade security or it suited to small company
- Simplified process of buying and selling
- Creation of public interest in risky, although viable ventures•
- Easy of making public sale of new issues.

Promoters

The OTCEI has been promoted by all financial institutions in India such as UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Capital Markets, etc.

BENEFITS TO THE INVESTORS

The OTC Exchange offers a number of benefits to the investors. They are as mentioned below:

- Quick payment of money to the sellers and quick delivery of shares to buyers
- Price transparency means buyer and seller know the actual price at which the scrips are bought or sold for him in other stock exchanges
- The OTCEI saves the investors from other unscrupulous behavior of the brokers
- Liquidity even for scrips of small and new companies
- Fair prices
- Simple procedure of buying and selling
- Facility to sell even odd lots.

BENEFITS TO THE COMPANIES

The OTC exchange offers certain benefits to the companies. The benefits are outlined below:

- It enables even smaller and less liquid companies to get listed
- Facilitate new issues at lower cost
- Market raising capital through issues easy for small, new and closely held companies
- Helps create market for scrips of small and new companies.

IMPACT OF CERTAIN ECONOMIC INDICATORS ON STOCK EXCHANGE/LIMITATIONS OF INDIAN STOCK MARKET/ DEFECTS OF INDIAN STOCK MARKET

The Indian Stock Market has suffered from many limitations. Important limitations are outlined below: These are the major factors for impact of certain economic indicators on stock exchange.

1. Absence of Genuine Investors

Speculative activities are created absence of genuine investors. Therefore, speculators always earn more profit from buying and selling of securities in the securities market. Most of the transactions are carry forward transactions with a speculative motive of deriving benefit from short term fluctuations.

2. Lack of Transparency

SEBI regulates stock exchanges in India but is unable to regulate the stock market operations of brokers and speculators. Many brokers and speculators are violating rules and regulations with a view to cheating to the customers in the market.

3. High Volatility of Stock Market

Research survey has indicated that the high price fluctuations in the capital market. The high price volatility is not good for smooth functioning of the stock market

4. Problem of Odd Lots

Odd lots means tradable securities are not listed in the market. This is the major problem to the security holders. It discourage to the trading activities to the investor.

5. Dominance of Financial Institutions

Financial institutions like LIC, UTI, GIC are dominated in the stock market. In addition, they majorly influence and control in the securities market in stock exchange.

6. Lack of Professionalism

Professionals are efficiently managed and Administration of the security operations. The lack of the professionalism has been creating several problems to investors, brokers and speculators. Professionals are aware of the financial institution role in the operation market. If lack, a problems for brokers and their clients.

7. Presence of Price Rigging

There is a strong bull moment in a market has created artificially demand for the products and push up the prices before the issues of securities. This process has generally done by a few group involved in buying and selling of the securities.

8. Prevalence of Insider Trading

Insider Trading has been a practice which is accepted in India although, SEBI has introduced many regulations to control the insider trading. Insider means insider are those who have access to unpublished price-sensitive information by virtue of their good positioning the company and who ready to use such information in their best merits.

9. Lack of Liquidity

Around 8000 companies are listed in Stock Exchanges in India. The shares of only a few companies are actively traded in the market and become they are liquid. Remaining shares of the listed companies are not actively traded in the market and become they are lack of liquidity.

10. Scarcity of Floating Securities

In the stock market, there is a scarcity of floating securities. The security market is highly volatile and easy price manipulations. In additionally, there is inadequate supply of good scrips and imbalance of demand and supply of securities in the market

REFORMS IN STOCK MARKET

- Regulation of Intermediaries
- Change in the management structure

- Insistence of quality securities
- Prohibition of insider trading
- Transparency of accounting practices
- Strict supervision of stock market operations
- Prevention of price rigging
- Encouraging of market making
- Discouragement of price manipulations
- Protection of investor's interest
- Free Pricing of Securities
- Freeing of Interest rates
- Setting up of Credit rating agencies
- Introduction of Electronic Trading
- Establishment of OTCEI and NSE
- Rolling settlement system

FINANCIAL MARKETS AND SERVICES

CHAPTER 2

NON BANKING FINANCE COMPANY

Non-Banking Financial intermediaries/ companies are the institutions which mobilizes funds by the way of deposits from the public and channelize these to meet the requirements of the borrowers in different sectors by making loans and advances, investments, leasing, factoring, hire purchase etc

A non-banking institution which is a company and has principal business of receiving deposits under any scheme of arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

1. NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:
2. NBFC cannot accept demand deposits;
3. NBFCs do not form part of the payment and settlement system and cannot issue

cheques drawn on it;

4. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

VARIOUS SERVICES OFFERED BY NBFIs

I. INVESTMENT COMPANY

Generally, an "investment company" is a company (corporation, business trust, partnership, or Limited Liability Company) that issues securities and is primarily engaged in the business of investing in securities.

An investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor's interest in the investment company. The performance of the investment company will be based on (but it won't be identical to) the performance of the securities and other assets that the investment company owns.

II. FINANCECOMPANY

Finance company is an organization that originates loans for both businesses and consumers. Much like a bank, a typical finance company acts as a lending entity by extending credit. However, the main difference between a bank and a finance company is that, unlike a bank, a finance company does not accept deposits from the public. Instead, a finance company may draw funding from banks and various other money market resources. A finance company may extend credit to individuals for various consumer purchases, as well as to corporations for commercial use. A finance company may also specialize in providing financing for a variety of instalment plan sales. A finance company may also be affiliated with a manufacturing firm or a holding company.

III. MERCHANTBANKS

Merchant Banker has been defined by SEBI (Merchant Bankers) rules, 1992 as “any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, or subscribing to securities or acting as manager, consultant, advisor, or rendering corporate advisory services in relation to such issue management. Merchant banks do not provide regular banking services to the general public.

SERVICES PROVIDED BY THE MERCHANT BANKER

1. Project Management

Merchant banker takes care of project management right from planning to commission of the project. They render various services as a part of project management. They are:

- Counseling
- Preparation of report
- Feasibility report
- Preparation of loan application
- Government clearance
- Foreign collaboration etc

2. Issue Management

It is mandatory under SEBI rules that every issuing company must appoint one or more SSEBI registered Merchant Bankers as Lead manager(s) for the management of issue. Merchant bankers play an important role as one of the intermediaries in the primary market. They undertake all the activities related to capital issues and play different roles as lead managers, co-managers, underwriters, consultants and advisors to the issue. They perform the duties of portfolio managers.

Issue management activities include

- A. Pre-issue management
- B. Post-issue management

A. Pre-issue management activities

Steps required to be taken to manage pre-issue activity is as follows:

- Obtaining stock exchange approvals to memorandum and articles of associations
- Taking action as per SEBI guidelines
- Finalizing the appointments of the following agencies:
 - Co-manager/ Advisers to the issue
 - Underwriters to the issue
 - Brokers to the issue
 - Bankers to the issue and refund banker
 - Advertising agency
 - Printers and registrar to the issue
- Advise the company to appoint auditors and legal advisers
- Drafting the prospectus
- Obtaining approvals of draft prospectus from the company's legal advisers, underwriting financial institutions/Banks
- Approval of prospectus from the SEBI
- Filing the prospectus with the Registrar of Companies (ROC)
- Making an application for enlistment with stock exchange along with copy of the prospectus
- Publicity of the issue with advertisement and conferences

B. Post – issue Management

Steps involved in post-issue management are:

- To verify and confirm that the issue is subscribed
- To supervise and co-ordinate the allotment procedure of registrar to the issue as per prescribed stock exchange guidelines
- To ensure issue of refund order, allotment letters/ certificates within the prescribed time limit after the closure of subscription list.
- To report periodically to the SEBI about the progress in the matters related to allotment and refunds
- To ensure the listing of securities in the stock exchange
- To attend the investors grievances regarding the public issue

3. Portfolio Management Services

Different merchant bankers provide portfolio management services by managing the portfolios of their clients. Merchant banker charges fees for providing portfolio services. Merchant bankers may or may not have the discretionary power of investing the funds.

4. Loan Syndication

Merchant Banker arranges huge amount of loans for their clients from different banks and financial institutions, this service is called loan syndication. Merchant bankers prepare project report for loan syndication, approaches different institutions and finalize the deal. For this service merchant banker charges some percentage of commission. Some of the important credit syndication services offered is:

- Preparing applications for financial assistance to be submitted to financial institutions and banks
- Monitoring the sanction of funds while acting as a specialized liaison agency
- Negotiating the term of assistance on behalf of client
- Post sanction formalities with these institutions and banks

5. Corporate Counseling

Merchant banker provides different types of corporate counseling to their clients related to areas such as product development, mergers and acquisitions, foreign collaborations,

rehabilitation of sick units etc. Some of the specific assignments for the merchant bankers are:

- Rejuvenating old line and ailing/sick units
- Assisting in obtaining approvals from Board for Industrial and Financial Reconstruction (BIFR)
- Evolving rehabilitation programmes/packages
- Monitoring implementation of schemes of rehabilitation
- Identifying potential buyers for disposal of assets
- Advice on tactics in approaching potential acquisition

6. Advisory services relating to mergers and takeovers

A merger is a combination of two or more companies into a single company where one survives and others lose their corporate existence. A takeover is the purchase of one company by another existing company who acquires, controls and shows an interest in the share capital of the other company. Merchant Bankers are the middlemen in setting negotiation between the offeree and offeror. Being a professional expert, it is the responsibility to safeguard the interest of the shareholders of both the companies.

7. Non-resident Investment

The services of merchant bankers include investment advisory services to NRIs in terms of identification of investment opportunities, selection of securities, investment management, etc. They also take care of the operational details like purchase and sale of securities, securing necessary clearance from RBI for repatriation of interest and dividend.

8. Other services

- Arranging External Commercial Borrowings
- Arranging and participating in international loan syndication
- Import Finance for Indian Corporate
- Debt Issue Management
- Private Placement
- Project Appraisal
- Corporate advisory services
- Share Valuations

IV. HIRE PURCHASE FINANCE

It is a method of buying goods through making instalment payments over time. The term hire purchase originated in the U.K., and is similar to what are called "rent-to-own" arrangements in the United States. Under a hire purchase contract, the buyer is leasing the goods and does not obtain ownership until the full amount of the contract is paid.

Hire Purchase is a method of selling good. In a hire purchase transaction, the goods are let out on hire by a finance company (creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes on to hirer on the payment of last installments.

FEATURES OF HIRE PURCHASE AGREEMENT

1. Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.
2. Each installment is treated as hire charges.
3. The ownership of the goods passes from buyer to seller on the payment of the installment
4. In case the buyer makes any default in the payment, the seller has the right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charges.
5. The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the amount already paid as it is considered as hire charges.

DIFFERENCE BETWEEN HIRE PURCHASE AND LEASING

Hire purchase is also different from leasing

1. **Ownership** – in a contract of lease , the ownership rests with the lessor throughout and the lessee (hirer) has no option to purchase the goods
2. **Method of financing**–leasing is a method of financing business assets whereas hire purchase is a method of financing both business assets and consumer articles

3. Depreciation – In leasing, depreciation and investment allowance cannot be claimed by the lessee. In hire purchase, depreciation and allowance can be claimed by the hirer.
4. Tax benefits – the entire lease rental is tax deductible expense .only the interest component of hire purchase installment is taxdeductible.
5. Salvage value – the lessee not being the owner of the asset, does not enjoy the salvage value of the asset. The hirer, in purchase, being the owner of the asset, enjoys the salvage value of theasset.
6. Deposit – lessee is not required to make any deposit whereas 20 percent deposit is required in hire purchase.
7. Rent purchase – with lease, we rent and with hire purchase we buy thegoods.
8. Extent of finance – lease financing is invariably 100 percent financing .it requires no immediate down payment or margin money by the lessee. In hire purchase, a margin equal to 20-25 percent of the asset is to be paid by thehirer.
9. Maintenance – the cost of maintenance of the hired asset is to be borne by the hirer himself .in case of finance lease only, the maintenance of leased asset is the responsibility of thelessee.
10. Reporting - the asset on hire purchase is shown in balance sheet of the hirer .the leased assets are shown by way of footnoteonly.

CRITERIA	HIRE PURCHASE	LEASING
Ownership	Financier	Lessor
Relationship	Owner-hirer	Lessor-lessee
Buying	Owner purchases and supplies to the hirer	Lessor purchases and supplies to lessee
Compensation	Hire charges	Lease rent
Repayment	Hire charges paid in installments	Lease rent paid periodically
Insurance	At owner's cost	At lessor's cost

V. LEASEFINANCE

A legal document outlining the terms under which one party agrees to rent property from another party. A lease guarantees the lessee (the renter) use of an asset and guarantees the lessor (the property owner) regular payments from the lessee for a specified number of months or years. Both the lessee and the lessor must uphold the terms of the contract for the lease to remain valid.

Lease is defined as follows

‘Lease is a form of contract transferring the use or occupancy of land, space, structure or equipment, in consideration of a payment usually in the form of rent’

-Dictionary of Business and Management

‘Lease is a contract whereby the owner of an asset (lessor) grants to another party (lessee) the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent’

-James C. Van Horne

‘A contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee .the lessor retains the ownership of the asset. The lessee has possession and use of the asset on payment of specified retain over the period’.

-Equipment Leasing Association of UK

STEPS INVOLVED IN LEASING TRANSACTION

The steps involved in a leasing transaction are summarised as follows:

1. First the lessee has to decide the asset required and select the supplier. He has to decide about the design specifications, the price, warranties, terms of delivery, servicing, etc.
2. The lessee then enters into a lease agreement with the lessor. The lease agreement contains the terms and conditions of the lease such as:
 - The basic lease period during which the lease is irrecoverable.
 - The timing and amount of periodical rental payments during the lease period.

- Details of any option to renew the lease or to purchase the asset at the end of the period.
 - Details regarding payment of cost of maintenance and repairs, taxes, insurance and other expenses.
3. After the lease agreement is signed, the lessor contacts the manufacturer and requests him, to supply the asset to the lessee. The lessor makes a payment to the manufacturer after the asset has been delivered and accepted by the lessee.

TYPES OF LEASE

1. FINANCIAL LEASE

A financial lease is also known as Capital lease, long-term lease, net lease and close lease. In a financial lease, the lessee selects the equipment, settles the price and terms of sale and arranges with a lease company to buy it. He enters into an irrevocable and non-cancellable contractual agreement with the leasing company. The lessee uses the equipment exclusively, maintains it, insures and avails the after-sales service and warranty backing it. He also bears the risk of obsolescence as it stands committed to pay the rental for the entire lease period.

The financial lease could also be with purchase option, where at the end of the predetermined period, the lessee has the option to buy the equipment at a predetermined value or at a nominal value or at fair market price. The financial lease may also contain a non-cancellable clause which means that the lessor transfers the title to the lessee at the end of lease period.

2. OPERATING LEASE

An operating lease is also known as service lease, short-term lease or true lease. In this lease, the contractual period between lessor and lessee is less than the full expected economic life of equipment. This means that the lease for a limited period, may be a month, 6 months, a year or few years. The lease terminable by giving stipulated notice as per the agreement. Normally, the lease rentals will be higher as compared to other leases on account of short period of primary lease. The risk of obsolescence is enforced on the lessor who will also bear the cost of maintenance and other relevant expenditure. The

lessor also does the services like handling warranty claims, paying taxes, scheduling and performing maintenance and keeping complete records lease suitable for:

1. Computers, copy machines and other office equipments, vehicles, material handling equipments, etc which are sensitive to obsolescence and
2. When the lessee is interested in tiding over temporary problem.

Difference between Financial Lease and Operating Lease

Financial Lease	Operating Lease
A financial lease is like an instalment loan. It is a legal commitment to pay for the entire cost of the equipment plus interest over a specified period of time. The lessee commits to a series of payment which in total exceed the cost of the equipment	An operating lease is a rental agreement. The lessee is not committed to paying more than the original cost of equipment during contractual period
It excludes provisions for maintenance or taxes which are paid separately by the lessee.	Operating lease provides for maintenance expenses and taxes of the lessor.
The risk of obsolescence is assumed by the lessee	Leasing company assumes risk of obsolescence
Contract period ranges from medium to long term	Contract period ranges from intermediate to short term.
Contracts are usually non-cancellable	Contracts are usually cancellable either by the lessor or by the lessee
Aircrafts, land and building, heavy machinery are leased	Computers, office equipments, automobiles, truck, etc are leased.
The lease involves a financial commitment similar to a loan by a leasing company. It places the lessee in a position of borrow	The financial commitment is restricted to regular rental payment. The rentals find a place in the P&L account of the lessee
The lessor fulfils financial function	The lessor fulfils the service function

3. LEVERAGELEASE

A leverage lease is used for financing those assets which require huge capital outlay. The outlay for purchase cost of the asset generally varies from Rs 50 lakh to Rs 2 crore and has economic life of 10 years or more. The leverage lease agreement involves three parties- the lessee, the lessor and the lender. The lessor acquires the assets as per the terms of the lease agreement but finances only a part of the total investment, say 20 per cent to 50 per cent. The balance is provided by a person or group of person in the form of loan to the lessor. The loan is generally secured by mortgage of the asset besides assignment of the leased rental payments. In leveraged lease, a wide range of equipments such as railroad, rolling stock, coal mining, electricity generating plants, pipelines, ships, etc are required.

4. SALE AND LEASEBACK

Under this type of lease, a firm which has an asset sells it to the leasing company and gets it back on lease. The asset is generally sold at its market value. The firm receives the sales price in cash and gets the right to use the asset during the lease period. The firms make periodical rental payment to the lessor. The title to the assets vests with the lessor. Most of the lease back agreements are on a net-to-net basis which means that the lessee pays all the maintenance expenses, property taxes and insurance. In some cases, the lessee agreement allows the lessee to repurchase the property at the termination of lease.

The sale and lease back agreement is beneficial to both lessor and lessee. The lessor gets immediate cash which becomes available for working capital or for further expansion and lessor gets tax benefits. Retail stores, official buildings, multipurpose industrial building and shopping centres are financed under this method.

5. CROSS-BORDERLEASE

Cross-border lease is international leasing and is known as transnational leasing. It relates to a lease transaction between a lessor and the lessee domiciled in different countries and includes exports leasing. In other words, the lessor may be of one country and the lessee may be of another country. To illustrate, if a leasing company in USA makes available an air bus on lease to air India, there would be a cross-border lease.

6. WET LEASE AND DRYLEASE

A wet lease is one where the lessor is responsible for full control and maintenance of leased asset. For instance, the jet airways has entered into a wet lease agreement with Oman Airways for two air buses for 6 months from may2009.

On the other hand, a dry lease involves the payment of insurance and maintenance costs by the lessee.

7. VENDORLEASING

A vendor leasing is one where the retail vendors tie up with the lease finance companies which give financing option to the customers of the vendors to purchase a product. This type of lease is popular in auto finance.

Advantages of leasing

The following are the advantages of leasing

1. **Permit alternative use of funds:** A leasing arrangements provides a firm with the use and control over asset without incurring huge capital expenditure. The firm is required only to make periodical rental payments. It saves considerable funds for alternative uses which would otherwise be tied up in fixedcapital
2. **Faster and cheaper credit:** Depending on tax structure of the lessee, it costs less than other methods of acquiring assets. It permits firms to acquire new equipment without going through formal scrutiny procedure. Hence, acquisition of assets under leasing agreement is cheaper and faster than any other source offinance.
3. **Flexibility:** Leasing arrangements may be tailored to the lessee's needs more easily the ordinary financing. Lease rentals can be structured to match the lessee's cash flows. It can be skipped during the months when the cash flows are expected to be low.
4. **Facilities additional borrowings:** Leasing may increase long-term ability to acquire funds. The lessee can utilize more funds for working capital needs. Moreover, acquisition of assets under the lease agreement does not alter debt-equity ratio. Hence, the lessee can go for additional borrowings in case needarise.

5. **Protection against obsolescence:** A firm can avoid risk of obsolescence by entering into operating lease agreement. This is highly useful in respect of assets which become obsolete at a fasterrate.
6. **No restrictive covenants:** The restrictive covenants such as debt-equity ratio, declaration of dividend, etc., which are usually imposed under debenture or loan agreement are absolutely absent in a leaseagreement.
7. **Hundred per cent financing:** Lease financing enables a firm to acquire the use of an asset without having to make a down payment. So, hundred per cent financing is assured to the lessee.
8. **Boon to small firm:** The firms which are either small or have uncertain records of earning are able to obtain the use of asset through lease financing. It is a boon to small firms and technocrats who are able to make promoter's contribution as required by financial institutions.

Disadvantages of Leasing

1. Lease is not suitable mode of project finance. This is because rentals are repayable soon after entering into lease agreement while in new projects cash generations may start only after a long gestationperiod.
2. Certain tax benefits/incentives such as subsidy may not be available on leased equipment.
3. The value of real assets such as subsidy may not be available on leasedequipment.
4. The cost of financing is generally higher than that of debtfinancing.
5. A manufacturer who wants to discontinue a particular line of business will be not in a position to terminate the contract except by paying heavy penalties. If it is a owned asset, the manufacturer can sell the equipment at hiswill.
6. If the lessee is not able to pay rentals regularly, the lessor would suffer a loss particularly the lessee. Hence, the lessee by himself is not entitled to any protection in case the supplier commits breach of warranties in respect of the leasedassets.
7. In the absence of exclusive laws dealing with the lease transaction, several problems crop up between lessor and lessee resulting in unnecessary complications and avoidabletension.

STRUCTURE OF LEASING COMPANY

The present structure of leasing industry in India consists of:

1. Private sector Leasing and
2. Public Sector Leasing.

The private sector leasing consists of:

1. Pure Leasing Companies,
2. Hire Purchase and Finance Companies, and
3. Subsidiaries of Manufacturing Group Companies.

The public sector leasing organizations are divided into:

1. Leasing Divisions of Financial Institutions,
2. Subsidiaries of Public Sector Banks, and
3. Other Public Sector Leasing Organizations.

Private Sector Leasing

- (i) **Pure Leasing Companies:** These companies operate independently without any link or association with any other organization or group of organization. The First Leasing Company of India Limited. The Twentieth Century Finance Corporation Limited, and the Grover Leasing Limited, falls under this category.
- (ii) **Hire purchase and finance companies:** The companies started prior to 1980 to do hire purchase and finance business especially for vehicles added leasing to their activities during 1980. Some of them do leasing as major activity and some others do leasing on a small scale as a tax planning device. Sundaram Finance Limited and Motor and General Finance Limited belong to this group.
- (iii) **Subsidiaries of manufacturing group companies:** These companies consist of two categories,
 - (a) Vendor leasing.
 - (b) In-house leasing.
 - (a) **Vendor Leasing:** These types of companies are formed to boost and promote the sale of its parent companies products through offering leasing facilities.

- (b) In-house leasing: In-house leasing or capture leasing companies are set up to meet the fund requirements or to avoid the income tax liabilities of the group companies.

PUBLIC SECTOR LEASING

- (i) Financial institution: the financial institutions such as IFCI, ICIC, IRBI and NSIC have set up their leasing divisions or subsidiaries to do leasing business. The shipping credit and investment company of India offers leasing facilities in foreign currencies for ships, deep seas' fishing vehicles and related equipments to its clients.
- (ii) Subsidiaries of banks: The commercial bank in India can, under Section 19(1) of the Banking Regulation Act, 1949, set up subsidiaries for undertaking leasing activities. The SBI was the first bank to start a subsidiary for leasing business in 1986.

Leasing in SBI is transacted through Strategic Business Unit (SBU) of the bank. Each SBU is manned but specially trained staff and is equipped with the latest technological aids to meet the needs of top corporate clients. For the bank as a whole, leasing is considered as a meet the needs of top corporate clients. For the bank as a whole, leasing is considered as a high growth area. Now, the bank as a whole, leasing is considered as a high growth area. Now, the bank is concentrating only on 'Big Ticket Leasing' which is generally of 5 crore and above. So far, SBI has disbursed more than 300 crore by way of leasing with the average size of deal being 25 crore.

- (iii) Other public sector organizations: A few public sector manufacturing companies such as Bharat Electronics Limited, Hindustan Packaging Company Limited and Electronic Corporation of India Limited have started to sell their equipment through leasing.

DIFFERENCE BETWEEN HIRE PURCHASE AND LEASING

Basis	Leasing	Hire Purchase
Meaning	A lease transaction is a commercial	Hire purchase is a type of

	arrangement, whereby an equipment owner or manufacturer conveys to the equipment user the right to use the equipment in return for a rental	instalment credit under which the hire purchaser agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase.
Asset purchase option	No option is provided to the lessee(user) to purchase the goods	Option is provided to the hirer(user)
Nature of expenditure	Lease rentals paid by the lessee are entirely revenue expenditure of the lessee	Only interest element included in the HP instalments is revenue expenditure by nature
Claiming of Depreciation	Lessee cannot claim depreciation	Hirer is although not the owner of the asset, for tax purpose, he can claim depreciation on the asset
Income Tax treatment	Entire lease rentals is tax deductible	Only interest component of hire purchase instalments is tax deductible

VI. HOUSING FINANCE COMPANY

Housing finance company is a company which carries on, as its principal business, the business of financing of acquisition or construction of houses, including acquisition or development of land in connection therewith.

RISK IN HOUSING FINANCE

Till recently, housing finance was considered to be a risky venture from the point of view of financial institutions due to the following reasons:

1. Large investment
2. Long term Advance
3. High Inflation Rate
4. High stamp Duty
5. Defective Title
6. High Delinquency Rate
7. Keen competition.

REASONS FOR THE POPULARITY OF HOUSING FINANCE

1. The corporate borrowers have started accessing the capital market for their financial requirements leaving surplus cash in the hands of bankers to lend to other sectors.
2. There is greater risk of lending to industries on account of recession.
3. The entry of foreign player with innovative retail financial products has compelled the Indian players also to enter into the retail finance field on large scale.
4. The development banks like IDBI and ICICI have been converted into commercial banks which has made the competition very tense and all banks vie with one another in attracting more and more customers by offering varieties of retail finance products.
5. There is an increase in the middle income group people in recent years. Again more families are found to be dual income families having a sizable disposable income at their hands.
6. One can also witness a shift in the attitude of the people i.e.; instead of having an attitude of 'save and buy' they have the attitude of 'buy and repay'.
7. Again low cost construction techniques have been developed motivating people to go for their own house on a large scale.
8. The interest rates on housing loans have been considerably reduced from 16 per cent to 18 per cent slab 8 per cent to 9 percent slab. Some of the bank charges even below their prime lending rates so as to motivate people to avail of housing loans on easy terms. This has considerably improved the borrower's ability to repay.
9. Similarly, the period for the loans has expanded from 5 to 7 years period to 20 to 30 years period.
10. The government has also taken some initiatives to popularize housing loans such as:
 - (a) Giving tax relief for housing loans.
 - (b) Repealing of land ceiling act in 199 to provide houses to weak and low income group.
11. The RBI has also taken the following initiatives to make housing loans proper:

- (a) Bringing housing loans under priority sector advances.
 - (b) Reducing the rest weightage from 100 per cent to 50 per cent for loans granted for acquiring residential houses.
 - (c) Deregulating the interest rates giving much freedom to lending institutions price their housing loan products according to their discretion.
 - (d) Reducing the CRR and SLR so that the lending capacity of financial institutions may increase with an improvement in their liquidity position.
12. Diversification of risk is possible by spreading the risk over a large number of borrowers which is not possible under wholesale lending.

HOUSING FINANCIAL PRODUCTS

Easy access at affordable rates has accelerated the tempo of housing activities in recent times. Different financial products have been introduced to cater to the vast housing requirements of varied people. Housing loans are given not only for construction, but also for extension, improvements etc. loans are given for furnishing houses and also for paying stamp duties. Banks have come forward to waive the processing fees. Housing loans are sanctioned for family planning clinics, health centers, educational, social, cultural and other institutions also. Shopping centers in residential areas can also avail housing loan facilities.

Generally, the following financial products are available in the housing market.

1. **Housing loan for purchase of homes:** This product is available purely for the purpose of either houses or flats or existing ones.
2. **House construction loan:** This product is available only for the construction of new house.
3. **Home extension loan:** This is available purely for expanding an already existing home.
4. **Home improvement loan:** This is granted for renovating an existing house.
5. **Flexible repayment loan:** This type of housing loan permits the borrower to fix the repayment schedule as per his option.
6. **Flexible loan installment plan:** Under this type of housing loan, the borrower can decide the amount of installment to be paid according to his discretion on the basis of his future earnings.

7. **Home transfer or conversion loan:** This product is available for those who have already availed of housing loans and want to move to another house for which additional funds are required. Under this type, the existing housing loan is transferred to the new housing loan amount without the necessity of settling the previous loan account.
8. **Home furnishing loan:** this product is available to furnish a housefully.
9. **Housing repayment or refinance loan:** This loan is available to redeem the prior debts incurred for the purchase of home from friends, relatives and other private sources.
10. **Housing loan transfer plan:** This is available to pay off an existing housing loan with higher interest rate and enjoy a new loan with lower rate of interest.
11. **Bridge loan for housing:** this product is available to those who wish to sell their old homes and purchase another. This loan is available for the new home until a suitable buyer is found for the oldhome.

VII. VENTURE CAPITAL FUNDS

Venture capital is a long term risk capital to finance high technology projects which involve risk but at the time has strong potential for growth. Venture Capitalists pool their resources including managerial abilities to assist new entrepreneurs in the early years of the project. Once the project reaches the stage of profitability, they sell their equity holdings at a high premium.

DEFINITION OF A VENTURE CAPITAL COMPANY

A venture capital company is defined as 'a financing institution which joins an entrepreneur as a co-promoter in a project and shares the risks and rewards of the enterprise

FEATURES OF VENTURE CAPITAL

Some of the features of venture capital financing are as under:

1. Venture capital is usually in the form of equity participation. It may also take the form of convertible debt or long-term loan.

2. Investment is made only in high risk but high growth potential project.
3. Venture capital is available only for commercialisation of new ideas or new technology and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development.
4. Venture capitalist joins the entrepreneur as a co-promoter in projects and shares the risks and rewards of the enterprise.
5. There is continuous involvement in business after making an investment by the investor
6. Once the venture has reached the full potential, the venture capitalist disinvests his holdings either to the promoter or in the market. The basic objective of investment is not profit but capital appreciation at the time of the disinvestment.
7. Venture capital is not just injection of money but also an input needed to set up the firm, design its marketing strategy and organize and manage it.
8. Investment is usually made in small – and medium – scale enterprises.

SCOPE OF VENTURE CAPITAL FUNDS

1. Development of an Idea- Seed capital:

In this initial stage capitalist provide seed capital for translating an idea into business proposition. At this stage investigation is made in-depth which normally takes a year or more.

2. Implementation stage-start up finance:

When the firm is set up to manufacture a product or provide a service, start up finance provide by the venture capitalist.

3. Fledging stage-Additional finance:

The firm has made headway and entered the stage of manufacturing a product but faces teething problems.

4. Establishment stage-establishment finance:

At this stage the firm is established in the market and expected to expand at rapid pace

IMPORTANCE OF VENTURE CAPITAL / ADVANTAGES

1. ADVANTAGES TO INVESTING PUBLIC

- The investing public will be able to reduce risk significantly against unethical management, if the public invest in venture fund who in turn will invest in equity of new business. With their expertise in the field and continuous involvement in the business, they would be able to stop malpractices by management.
- Investors have means to vouch for the reasonableness of the claims made by the promoters about profitability of the business. The venture funds equipped with necessary skills will be able to analyze the prospects of the business.
- The investors do not have any means to ensure that the affairs of the business are conducted prudently. The venture fund having representatives on the board of directors of the company would overcome it.

2. ADVANTAGES TO PROMOTERS

- Venture capital provides a solid capital base for future growth by injecting long-term equity financing.
- Public issue of equity shares has to be preceded by a lot of efforts namely necessary statutory sanctions, underwriting and brokers arrangement, publicity of issue, etc. the new entrepreneurs find it very difficult to make underwriting arrangements which require a great deal of efforts. Venture fund assistance would eliminate those efforts by leaving entrepreneur to concentrate upon the activities of the business.
- Costs of public issues of equity share often range from 10% to 15% of nominal value of issue of moderate size, which are often even higher for small issues. These expenses can be ill-afforded by the business when it is new. Assistance from venture funds does not require such expenditure.

Business partners: The venture capitalist act as business partners who share the rewards as well as the risks.

Mentoring: Venture capitalist provide strategic, operational, tactical and financial advice based on past experience with other companies in similar situations.

Alliances: the venture capitalists helps in recruitment of key personnel, improving relationship with international markets, co-investment with other VC firms and decision making.

3. GENERAL

- A developed venture capital institutional set-up reduces the time-lag between a technological innovation and its commercial exploitation.
- It helps in developing new process, products in conducive atmosphere, free from the dead-weight of corporate bureaucracy, which helps in exploiting full potential.
- Venture capital acts as a cushion to support business borrowings, as bankers and investors will not lend money with inadequate margin of equity capital
- Once venture capital funds start earning profits, it will be very easy for them to raise resources from primary capital market in the form of equity and debts. Therefore, the investors would be able to invest in new business through venture funds and at the same time they can directly invest in existing business when venture fund disposes its own holding.
- The economy with well-developed venture capital network induces the entry of large number of technocrats in industry, helps in stabilizing industries and in creating a new set of trained technocrats to build and manage medium and large industries, resulting in faster industrial development.
- A venture capital firm serves as an intermediary between investors looking for high returns for their money and entrepreneurs in search of needed capital for their start-ups.
- It also paves the way for private sector to share the responsibility with public sector.

METHODS OF VENTURE FINANCING

Venture capital is available in four forms in India:

1. Equity participation
2. Conventional loan
3. Conditional loan
4. Income notes

1. **EQUITY PARTICIPATION:** The venture capital firms participate in equity through direct purchase of shares but their stake does not exceed 49 per cent. These shares are retained by them till the assisted projects make profit. These shares are sold either to the promoter at negotiated price under buyback agreement or to the public in the secondary market at a profit.
2. **CONVENTIONAL LOAN:** Under this form of assistance, a lower fixed rate of interest is charged till the assisted units become commercially operational, after which the loan carries normal or higher rate of interest. The loan has to be repaid according to a predetermined schedule of repayment as terms of loan agreement.
3. **CONDITIONAL LOAN:** Under this form of finance, as interest – free loan is provided during the implementation period but it has to pay royalty on sales. The loan has to be repaid according to a predetermined schedule as soon as the company is able to generate sales and income.
4. **INCOME NOTES:** It is a combination of conventional and conditional loans. Both interest and royalty are payable at much lower rates than in case of conditional loans.

VIII. FACTORING

It is a financial intermediary that purchases receivables from a company. A factor is essentially a funding source that agrees to pay the company the value of the invoice less a discount for commission and fees. The factor advances most of the invoiced amount to the company immediately and the balance upon receipt of funds from the invoiced party.

Factoring is a financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount in exchange for immediate money with which to finance continued business.

A study group appointed INTERNATIONAL INSTITUTE for the Unification of Private Law (UNIDROIT) ROME 1988 defines:-

“Factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor-

- Finance
- Maintenance of accounts
- Collection of debts

- Protection against credit risk

Why a firm uses factoring

- Factoring is used by a firm when the available Cash Balance held by the firm is insufficient to meet current obligations and accommodate its other cash needs, such as new orders or contracts

Parties involved in factoring

1. Client
2. Customer
3. Factor
4. Buyer Seller Financer buys invoices collection

Services offered by a factor

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

Process involved in factoring

- Client concludes a credit sale with a customer.
- Client sells the customer's account to the Factor and notifies the customer.
- Factor makes part payment (advance) against account purchased, after adjusting for commission and interest on the advance.
- Factor maintains the customer's account and follows up for payment.
- Customer remits the amount due to the Factor.
- Factor makes the final payment to the Client when the account is collected or on the guaranteed payment date.

Mechanics of factoring

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

Charges for factoring services

- Factor charges Commission (as a flat percentage of value of Debts purchased) (0.50% to 1.50%)
- Commission is collected up-front.
- For making immediate part payment, interest charged. Interest is higher than rate of interest charged on Working Capital Finance by Banks.
- If interest is charged up-front, it is called discount.

FUNCTIONS OF FACTORING

As stated earlier, the term 'factoring' simply refers to the process of selling trade debts of a company to a financial institution. But, in practice, it is more than that. Factoring involves the following functions.

1. Purchase and collection of debts
2. Sales ledger management
3. Credit investigation and undertaking of credit risk
4. Provision of finance against debts, and

5. Rendering consultancy services

1. **Purchase and collection of debts:** Factoring envisages the sale of trade debts to the factor by the company, i.e., the client. It is where factoring differs from discounting. Under discounting, the financier simply discounts the debts backed by account receivables of client. He does so as an agent of the client. But, under factoring, the factor purchases the entire trade debts and thus, he becomes a holder for value and not an agent. Once the debts are purchased by the factor, collection of those debts becomes his duty automatically.
2. **Sales Ledger Management:** This function is an important one in factoring. Once the factoring relationship is established, it becomes the factors responsibility to take care of all the functions relating to the maintenance of sales ledger. The factor has to credit the customer's account whenever payment is received, send monthly statements to the customers and to maintain liaison with the client and the customer to resolve all possible disputes. He has to inform the client about the balances in the account, the overdue period, the financial standing of the customers, etc. Thus, the factor takes up the work of monthly sales analysis, overdue invoice analysis and credit analysis.
3. **Credit investigation and undertaking of credit risk:** The factor has to monitor the financial position of the customer carefully, since; he assumes the risk of default in payment by customers due to their financial inability to pay. This assumption of credit risk is one of the most important functions which the factor accepts. Hence, before accepting the risk, he must be fully aware of the financial viability of the customer, his past financial performance record, his future ability, his honesty and integrity in the business world, etc. For this purpose, the factor also undertakes credit investigation work.
4. **Provision of finance:** After the finalization of the agreement and sale of goods by the client, the factor provides 80% of the credit sales as prepayment to the client. Hence, the client can go ahead with his business plans or production schedule without any interruption. This payment is generally made without any recourse to the client. That is, in the event of non-payment, the factor has to bear the loss of payment.
5. **Rendering consultancy services:** Apart from the above services, the factor also provides management services to the client. He informs the client about the additional business opportunities available, the changing business and financial profiles of the customers, the likelihood of approaching recession, etc.

TYPES OF FACTORING

The type of factoring services varies on the basis of the nature of transaction between the client and the factor, the nature and volume of client's business, the nature of factor's security, etc. In general, the factoring services can be classified as follows,

1. Full service factoring or without recourse factoring
2. With recourse factoring
3. Maturity factoring
4. Bulk factoring
5. Invoice factoring
6. Agency factoring
7. International factoring
8. Suppliers guarantee factoring
9. Limited factoring
10. Buyer based factoring
11. Seller based factoring

1. Full service factoring or without recourse factoring

Under this type, a factor provides all kinds of services discussed above. Thus a factor provides finance, administers, the sales ledger, collects the debts at his risk and renders consultancy services. This type of factoring is a standard one. If the debtors fail to repay the debts, the entire responsibility falls on the shoulders of the factor since he assumes the credit risk also. He cannot pass on this responsibility to his clients and, hence, this type of factoring is also called without recourse factoring.

2. With recourse factoring

As the very name suggests, under this type, the factor does not assume the credit risk. In other words, if the debtors do not repay their dues in time and if their debts are outstanding beyond a fixed period say 60 or 90 days from the due date, such debts are automatically assigned back to the client. The client has to take up the work of collection of overdue account himself. If the client wants the factor to go on with the collection work of overdue accounts, the client has to pay extra charge called 'refactoring charges'

3. Maturity factoring

Under this type, the factor does not provide immediate cash payment to the client at the time of assigned of debts. He undertakes to pay cash as and when collections are made

from the debtors. The entire amount collected less factoring fees is paid to the client immediately. Hence, it is also called 'collection factoring'. In fact, under this type, no finance is involved. But all other services are available.

4. Bulkfactoring

Under this type, the factor provides finance after disclosing the fact of assignment of debts to the debtor concerned. This type of factoring is resorted to when the factor is not fully satisfied with the financial condition of the client. The work relating to sales ledger administration, credit control, collection work, etc. has to be done by the client himself. Since the notification has been made, the factor simply collects the debts on behalf of client. This is otherwise called 'disclosed factoring' or 'notified factoring'.

5. Invoice factoring

Under this type, the factor simply provides finance against invoices without undertaking any other functions. All work connected with sales administration, collection of dues, etc. has done by the client himself. The debtors are not at all notified and hence they are not aware of the financing arrangement. This type of factoring is very confidential in nature and hence it is called 'confidential invoice discounting' or 'undisclosed factoring'.

6. Agencyfactoring

The word agency has no meaning as far as factoring is concerned. Under this type, the factor and the client share the work between themselves as follows:

- a) The client has to look after the sales ledger administration and collection work, and,
- b) The factor has to provide finance and assume the credit risk.

7. International factoring

Under this type, the services of a factor in a domestic business are simply extended to international business. Factoring is done purely on the basis of the invoice prepared by the exporter. Thus, the exporter is able to get immediate cash to the extent of 80 per cent of the export invoice under international factoring. International factoring is facilitated with the help of export factors and import factors.

8. Suppliers guarantee factoring

This type of factoring is suitable for business establishments which sell goods through middlemen. Generally, goods are sold through wholesalers, retailers or through middlemen. In such cases, the factor guarantees the supplier of goods against invoices raised by the supplier upon another supplier. The bills are assigned in favor of the factor who guarantees payment of those bills. This enables the suppliers to earn profits without much financial involvement.

9. Limited factoring

Under this type, the factor does not take up all the invoice of a client. He discounts only selected invoices on merit basis and converts credit bills into cash in respect of those bills only.

10. Buyer based factoring

In most cases, the factor is acting as an agent of the seller. But under this type, the buyer approaches a factor to discount his bills. Thus, the initiative for factoring comes from the buyers end. The approved buyers of a company approach a factor for discounting their bills to the company in question. In such cases, the claims on such buyers are paid by discounting the bills without recourse to the seller and the seller also gets ready cash. This facility is available only to reputed creditworthy buyers and hence it is also called 'selected buyer based factoring'.

11. Seller based factoring

Under this type, the seller, instead of discounting his bills, sells all his accounts receivables to the factor, after invoicing the customers. The seller's job is over as soon as he prepares the invoices. Thereafter, all the documents connected with the sales are handed over to the factor who takes over the remaining functions. This facility is extended to reputed and creditworthy sellers and hence it is also called 'selected seller based factoring'.

BENEFITS OF FACTORING

1. Financial service
2. Collections service
3. Credit risk service
4. Provision of expertise 'Sales Ledger Management'
5. Consultancy service
6. Economy in servicing
7. Trade benefits

FINANCIAL MARKETS AND SERVICES

CHAPTER 3

SECURITIES EXCHANGE BOARD OF INDIA (SEBI)

MALPRACTICES IN SECURITIES MARKET

With the growth of securities market, the number of malpractices also increased in both the primary and secondary markets. The malpractices were noticed in the case of companies, merchant bankers and brokers who are all operating in the market.

A few examples of malpractices are as follows:

1. Manipulation of security prices: companies issuing securities, often, artificially push up the prices before the issue of securities. This process starts well before a company seeks permission from the government for the issue of further capital. It is not only an attempt to get a higher premium on the basis of manipulated prices but also to lure investors to subscribe to these further issues.
2. Price rigging: a common way of pushing up the prices is to resort to circular trading – three or four parties buy and sell stocks among themselves and push the prices up.
3. Insider trading: insider trading by agents of companies or brokers caused wide fluctuations in the prices of securities. Many companies have intricate network of brokers, their clients, friends and associates. The insiders who are privy to price – sensitive information use such information to their advantage and build –up large fortunes.
4. Delay in settlement: this delay is noticed in giving delivery of shares, making payments to clients and passing contract notes.
5. Delay in listing: delay in listing and commencement of trading in shares was also prevalent.

DEFICIENCIES IN THE MARKET

Besides the Indian stock market is said to be deficient in the following respects:

1. Lack of diversity in financial instruments: lack of variety in the financial instruments available is one of the defects of the stock market. Equity shares and convertible

Prof. LAKSHMI SN

debentures seem to be the only instruments in the armoury of companies. Preference shares, rights debenture, etc., are not issued by the companies.

2. Disclosure of financial information: the efficiency of the capital market depends upon the availability of reliable and complete information about the issues and companies. The prospectus issued by a company does not contain adequate and relevant information to enable investors to take correct investment decisions. Sometimes, the information given is misleading and deceptive. Further, the brochures and pamphlets and advertisements issued at the time of public issue tend to prevent a biased profile of the company.
3. Preponderance of speculative trading: a major portion of transactions in stock market are done by speculative motive. The main motive is to derive benefit from short term price fluctuations. Only a very small fraction of transactions represent purchase/sale by genuine investors.
4. Poor liquidity: The Indian stock market suffers from poor liquidity. Only a small portion of shares are actively traded and highly liquid. Most shares are traded infrequently and hence lack liquidity.
5. Lack of control over brokers: lack of control over the activities of brokers and jobbers is another deficiency of capital market. Significantly, few people are able to cause fluctuations in the market activity. Besides, many of them lack high professional standards.

INTRODUCTION TO SEBI

SEBI was set as a non statutory body on 12th April, 1988. It got its statutory power in the year 1992.

OBJECTIVES OF SEBI

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

FUNCTIONS OF SEBI

1. Regulatory functions:

- a) Regulation of stock exchange and self regulatory organisation.
- b) Registration and regulation of stock brokers, sub brokers, merchant bankers, underwriters, portfolio managers etc
- c) Prohibition of insider trading in securities
- d) Regulating substantial acquisition of shares and takeover of companies.
- e) Prohibition of fraudulent and unfair trade practices relating to securities market.

2. Development functions

- a) Promote investor education
- b) Training of intermediaries
- c) Conducting research and published information useful to all market participants
- d) Promotion of fair practices. code of conduct for self regulatory organisations
- e) Promoting self regulatory organisations
- f) Information and Research functions: collects and disseminates information and conducts research in this field.
- g) Supervision of Banks: It has the extensive power of supervision and control over commercial and cooperative banks. It has power to call for information and give directions to them.
- h) Monetary data and publications: it is the main source of information about monetary data and Banking system.
- i) Promotional functions: It has been performing a variety of promotional functions towards building and strengthening of financial infrastructure by promoting commercial, co operative, industrial and agriculture banks and also promotion of finance of exports.

POWERS OF SEBI

1. Power to call for periodical returns from recognised stock exchange
2. Power to call for any information or explanation from recognised stock exchanges
3. Power to direct enquiries to be made in relation to affairs of stock exchanges or their members

4. Power to grant approval to bye laws of recognised stockexchange
5. Power to make or amend bye laws of recognised stockexchange
6. Power to compel listing of securities by publiccompanies
7. Power to control and regulate stock exchanges
8. Power to grant registration to marketintermediaries
9. Power to levyfees.

ORGANISATION OF SEBI

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

- Issue Department which issuescurrencies
- Banking Development helps to develop banking in allareas
- Banking operation helps in controlling, supervising and regulating working of banking functions and also helps in granting licences to open newbranches
- Non Banking Companies: Supervises the functioning ofNBFCs

SEBI is divided into 4 operational departments:

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

Other departments

- Legal Affairs: provides legal advice on legalissues.
- Exchange Control: deals with sale & purchase ofForex
- Agriculture credit

- Industrial Finance
- Economics Department to frame banking policies
- Research Statistics: Collection of details relating to money, credit, production etc.
- Banking department keeps the RF of Commercial banks and assistance to FIs
- Inspection department: inspects local offices of commercial banks
- Planning and reorganisation: formulates new policies and plans
- RBI services board deals in recruitment, selection
- Accounts and Expenditure maintains the receipts and expenses.
- Supervision: supervising commercial banks
- Control department: controls the affairs
- External investments and operations
- Press relations
- Industrial Export credit.

SEBI GUIDELINES

SEBI has brought out a number of guidelines separately from time – to – time, for primary market, secondary market, mutual funds, merchant bankers, foreign institution investors, investor protection etc . The guidelines are described below.

1. Guidelines for Primary Market

New company: A new company is one (a) which has not completed 12 months commercial production and does not have audited results and (b) where the promoters do not have a track record. These companies will have to issue shares only at par.

New company set up by existing company: when a new company is being set up by existing companies with a five-year track record of consistent profitability and a contribution of at least 50% in the equity of new company, it will be free to price its issue. i.e., it can issue its share at premium.

Private and closely held companies: The private and closely held companies having a track record of consistent profitability for at least three years shall be permitted to price their issues freely. The issue price shall be determined only by the issues in consultation with lead managers to the issue.

Existing listed companies: the existing listed companies will be allowed to raise fresh capital by freely pricing expanded capital provided the promoters contribution is 50% on first Rs 100 crore of issue, 40% on next Rs 200 crore, 30% on next Rs 300 crore and 15% on balance issue amount.

Reservation of issues

Reservation under public subscription for various categories of persons are made in the following manner:

1. Permanent employees-10%
2. Indian mutual funds-20%
3. Foreign institutional investors-15%
4. Development financial institutions-20%
5. Shareholders of group of companies-10%

Composite issues

In the case of composite issue, i.e., right-cum-public issue by existing listed companies, differential pricing shall be allowed. In other words, issue to the public can be priced differentially as compared to issue to rights shareholders. However, justification for the price difference should be given in the offer document.

Lock – in – period

Lock-in period is 5 years for promoter's contribution from the date allotment or from the commencement of commercial production whichever is late. At present, the lock-in period has been reduced to one year.

GUIDELINES FOR PUBLIC ISSUE:

1. Abridged prospectus has to be attached with heavy application.
2. As company has to highlight the risk factors in the prospectus.
3. Objective of the issue and cost of project should be mentioned in the prospectus.
4. Company's management, passed history and present business of the firm should be highlighted in the prospectus.

5. Particulars with regard to company and other listed companies under the same management which made any capital issues during the last three years are to be stated in the prospectus.
6. Justification for premium in the case of premium is to be stated.
7. Subscription list for public issues should be kept open for a minimum of three days and a maximum of ten working days.
8. The collection centres should be at least thirty which include all centres with stock exchanges.
9. Collection agents are not to collect application money in cash.
10. The quantum of issue, whether through a rights or public issue, shall not exceed the amount specified in the prospectus. No retention of over subscription is permissible under any circumstances.
11. A compliance report in the prescribed form should be submitted to SEBI within 45 days from the date of closure of issue.
12. Minimum number of shares per applications has been fixed at 500 shares of face value of Rs.100.
13. The allotments have to be made in multiples of tradable lot of hundred shares of Rs.10 each.
14. Issues by way of bonus, rights, etc., to be made in appropriate lots to minimize odd lots.
15. If minimum subscription of 90% has not been received, the entire amount is to be refunded to investors within 120 days.
16. The capital issue should be fully paid up within 120 days.
17. Underwriting has been made mandatory.
18. Limit of listing of companies issue in the stock exchange has been increased from Rs.3 crore to Rs.5 crore.
19. The gap between the closure dates of various issue, viz., rights and public should not exceed 30 days.
20. Issues should make adequate disclosure regarding the terms and conditions of redemption, security conversion and other relevant features of the new instrument so that an investor can make a reasonable determination of risks, returns, safety and liquidity of instrument. The disclosure shall be vetted by SEBI in this regard.
21. SEBI has made grading of all IPO mandatory for which draft documents are filed with it after April 30, 2007.

It shall be mandatory to obtain grading from at least one credit rating agency.

The issues shall be required to disclose all grades obtained by it in the prospectus , abridged prospectus , issue advertisements and other places where the issues is advertising for the IPO, EBI has announced on august 5 , 2008 that am alternate payment mode would ensure that the funds of retail investors are no locked until the actual allotment of shares . on September 10 , 2008 , five banks have agreed to debit application money only when it is required and not 21 days in advance and the registrar to give instruction to block the amount only when it was required .

2. SecondaryMarket

STOCK EXCHANGE

1. Board of directors of stock exchange has to be reconstituted so as to include non-members, public representatives, government representatives to the extent of 50 per cent of total number of members.
2. Capital adequacy norms have been laid down for members of various stock exchanges depending upon their turnover of trade and other factors.
3. Working hours for all stock exchanges have been fixed uniformly.
4. All the recognized stock exchanges will have to inform about the transaction within 24 hours.
5. Guidelines have been issued for introducing the system of market –making is less liquid scrips in a phased manner in all stock exchanges.

BROKERS

1. Registration of brokers and sub-brokers in made compulsory.
2. In order to ensure that brokers are professionally qualified and financially solvent, capital adequacy norms for registration of brokers have been evolved.
3. Compulsory audit of broker's book and filling of audit report with SEBI have been made mandatory.
4. To bring about greater transparency and accountability in the broker-client relationship, SEBI has made it mandatory for brokers to disclose transaction price and brokerage separately on the contract notes issued to client.
5. No broker is allowed to underwrite more than 5 per cent of public issue.

FOREIGN INSTITUTIONAL INVESTORS

1. Foreign Institutional Investors have been allowed to invest in all securities traded in primary and secondary markets.
2. There would be no restriction on the volume of investment for the purpose of entry of FIIs.
3. The holding of single FII in a company will not exceed the ceiling of 5 per cent of the equity capital of a company.
4. Disinvestment will be allowed only through stock exchanges in India.
5. FIIs have to pay a concessional tax rate of 10 per cent on large capital gain and 30 percent on short term capital gains. A tax rate of 20 per cent on dividend and interest is prescribed.

INVESTORS' PROTECTION

Need for investors protection

1. To instil confidence in investor mind
2. To create a conducive atmosphere for investment
3. To ensure transparency in dealing
4. To create a vibrant capital market
5. To regulate the market on sound lines
6. To create discipline in the market
7. To create accountability among market players
8. To create awareness among investors

Factors affecting investors' interest

1. Price rigging
2. Insider trading
3. Excessive speculation
4. Lack of transparency
5. Short selling
6. Retired trading
7. Restricted trading hours and trading days
8. Dominance of few stock exchange

9. Dominance of institutional and foreign institutional investor
10. Excessive volatility
11. Grievance against listed companies

Moreover, the investor complaints against listed companies are manifold. Some of them are:

- a) Non receipt of share certificates
- b) Non receipt of refund orders
- c) Non receipt duplicate securities
- d) Non receipt of certificate after consolidation
- e) Non receipt of certification after splitting
- f) Bad delivery of share certificate
- g) Failure to effect transfers and delay in executing them
- h) Non receipt in interest on listed debenture
- i) Non receipt of redemption prices of listed debentures
- j) Non receipt of allotment above.
- k) Compliance regarding revalidations

12. Grievance against members of stock exchange: The nature of complaints against the members of stock exchange are:

- a) Non receipt of delivery of shares
- b) Non receipt of dividend.
- c) Non receipt of the shares
- d) Non receipt of bonus shares
- e) Non receipt of sale proceeds
- f) Disputes relating to non settlement of accounts
- g) Disputes regarding rate difference, etc.
- h) Miscellaneous grievances

Miscellaneous grievances arise due to

1. Non repayment of fixed deposit on financial companies
2. Non repayment of deposits in manufacturing company
3. Non redemption of mutual funds and all completed relating to mutual funds
4. Complaints relating to shares and debentures in insurance companies

ROLE OF SEBI IN MARKETING AND PROTECTING THE INTEREST OF INVESTORS

SEBI has been mandated to protect the interest of investors in securities and to promote the development of and to regulate the securities market contributing to Indian economy.

SEBI has undertaken various steps to protect the interest of small investors. They are:

a) Relating to new issue

b) Relating to derivatives

A) Relating to new issue: SEBI securities, drafts, prospects of company for full and fair disclosures.

- I. It makes sure that issuing company provides fair and correct information.
- II. It ensures transparent allotment mechanism
- III. SEBI has ensured that underwriting obligation is necessary to inspire confidence of investors.
- IV. It ensures timely and transferability of the issue.
- V. No delay in refunds or dispatch of share certificate.
- VI. Listing should be timely and transferability is ensured
- VII. Both stock exchange and companies are responsible for investor protection in respect of free trading and transferability of shares.
- VIII. The investor's protection is not only ensured by the director/secretary of company but also by all the parties involved in the issue of shares like Merchant bankers, registrars, collecting banks, stock exchange and SEBI.
- IX. An investor's grievance cell is set up to handle investor's complaints.
- X. SEBI has issued few investors guidance, advertisement and published a book on Investors grievance- rights and remedies. It also has an active investors association.
- XI. Curtailing unfair trade practice like insider trading.

Insider Trading : It takes place when insider or any person who by virtue of their position in office or otherwise have access to unpublished price and sensitive information relating to the affairs of the company, A penalty of Rs.500000 is imposed for those who indulge in insider trading.

Stock investment: It was designed by SEBI has an additional facility for making application for new issues. Individuals can approach the bank with which they maintain an account for issue of stock invest of required denomination for payment of application money, while making an application for shares.

B) Relating to derivatives: the trading member is required to provide every investor with a risk disclosure document, Investor would get contract note duly stamped for receipt of the order and execution of order. In derivative markets, all money paid by the investor towards margins on all open positions is kept in trust with clearing house or clearing corporation and in the event of default of the trading or clearing members, the amount paid by the client towards margin are segregated and not utilised towards the default of the member.

FINANCIAL MARKETS AND SERVICES

CHAPTER 4

MUTUAL FUNDS

INTRODUCTION, MEANING AND DEFINITION

The fund established in the form of a trust by sponsor to raise money by the trustees through sale of units to the public under one or more schemes for investing in securities in accordance with the regulation. In general meaning, a mutual fund mobilising the savings from small investors, invest them in Government and other corporate securities and earn income through interest and dividends, besides capital gains. It works on the general principle of “small drops of water make a big ocean”. For example, if one has invested Rs. 1,000, it may not fetch very much on its own. Therefore, when it is pooled with Rs. 1,000 each from a lot of other people, then, one could create a ‘big fund’ large enough to invest in a wide varieties of shares and debentures on a commanding scale and thus, to enjoy the economies of large scale operations. However, a mutual fund is nothing but a form of mobilising investment from the small investors who transfer their saving into professionally qualified organisation to manage it. Mutual fund has emerged as a popular vehicle of creation of wealth due to high return, lower cost and diversified risk.

According to Weston J. Fred and Brigham, Eugene, F., Unit Trusts are “Corporation which accept dollars from savers and then use these dollars to buy stocks, long term bonds, short term debt instruments issued by business or government units: these corporations pool funds and reduce risk by diversification.” All these definitions reveal that the mutual funds are corporations which pool funds by selling their own shares and reduce risk by diversification.

FEATURES OF MUTUAL FUNDS

1. A mutual fund belongs to those who have contributed to that fund and thus, the ownership of the fund lies in the hands of the investors.
2. Since all investors cannot take part in the management of the fund, it is left in the hands of investment professionals who earn a fee for their service

3. The pool of funds collected is invested in a portfolio of marketable securities
4. The investors' share in the fund is represented by 'units' just like shares in the case of share capital of a company.
5. The unit value depends upon the value of the portfolio held by the fund. Hence, the value changes almost every day and it is called Net Asset Value.
6. Generally, the investment portfolio of the mutual fund is created according to the objective of the fund. For example, a sectoral mutual fund invests its funds in a specific sector like IT sector, oil sector, etc.

IMPORTANCE OF MUTUAL FUNDS

1. Channelizing and mobilising savings for investment.
2. It is offering wide folio investment in different schemes.
3. Mutual funds are providing better yields to investors.
4. Mutual fund companies are rendering specialized investment service at low cost.
5. Mutual fund companies are mobilising corpus from individual investors; therefore, they are providing research service.
6. Mutual funds are widely offering tax benefits to investors.
7. Mutual funds are introducing flexible investment schedule.
8. Mutual funds are providing greater affordability and liquidity.
9. Mutual funds have simplified record keeping.
10. It's support to capital market and money market.
11. It is providing Industrial Development.
12. Mutual funds acting as substitute for initial public offering.
13. Mutual funds are reducing the market cost of new issues.
14. It is keeping the money market active.

Scope of mutual funds

- 1) Organization of the fund lies in the hands of investors.
- 2) Investment is left in the hands of progression who earn fee for services.
- 3) It is invested in a portfolio of marketable securities.

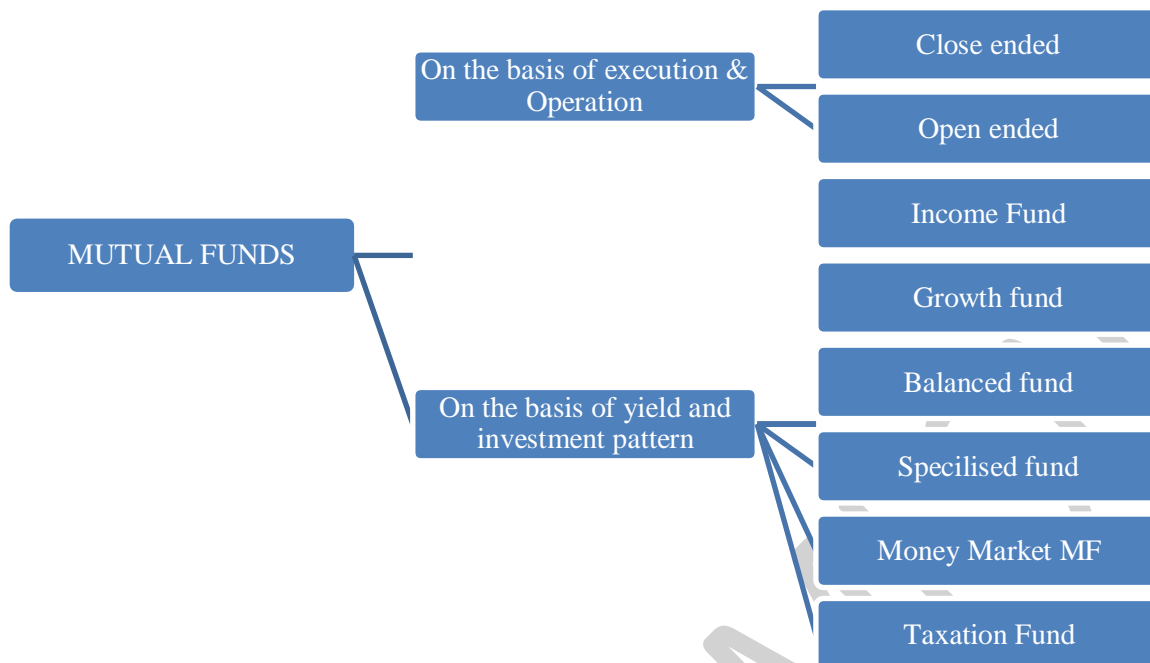
- 4) It is represented in units.
- 5) It is invested in specific sector like IT sectors, fertilizer industries, ETC.

Advantages of Mutual Funds

Mutual funds are becoming very popular worldwide because of the following important advantages

1. **Diversification:** a large number of investors have small savings with them. They can at the most buy share of one or two companies
2. **Expert supervision and management:** a small investor cannot be expert in portfolio management. When he invests in mutual funds, he gets the benefit of expert supervision and management which mutual funds can offer because of large resources at their disposal.
3. **Liquidity:** a peculiar advantage of mutual funds is that investment made in its schemes can be converted back into cash promptly without heavy expenditure on brokerage, delays, etc.
4. **Reduced risk:** as mutual funds invest in a large number of companies and are managed professionally, the risk factor of the investor is reduced.
5. **Tax advantage:** there are certain schemes of mutual funds which provide tax advantages under the income tax act
6. **Low operating costs:** mutual funds have large investible funds at their disposal and thus can avail economies of large scale
7. **Flexibility:** mutual funds provide flexible investment plans to its subscribers such as, regular investment plans, regular withdrawal plans and dividend reinvestment plans, etc.
8. **Higher return:** mutual funds are expected to provide higher returns to the investors as compared to direct investment because of professional management, economies of scale, reduced risk, etc.
9. **Investor protection:** the regulation of 1993, provides better protection to the investors, and imparts a greater degree of flexibility and facilities competition

TYPES OF FUNDS/ CLASSIFICATION OF MUTUAL FUNDS



ON THE BASIS OF EXECUTION AND OPERATION

1. CLOSE-ENDEDFUNDS

Under this scheme, the corpus of the fund and its duration are prefixed. In other words, the corpus of the fund and the number units are determined in advance. Once the subscription reaches the predetermined level, the entry of investors is closed. After the expiry of the fixed period, the entire corpus is disinvested and the proceeds are distributed to the various unitholders in proportion to their holding. Thus, the fund ceases to a fund, after the final distribution.

FEATURES

The main features of the close-ended funds are:

- The period and / or the target amount of the fund is defined and fixedbeforehand.
- Once the period is over and / or the target is reached, the door is closed for the investors .they cannot purchase any moreunits.
- These units are publicly traded through stock exchange and generally, there is no purchase facility by thefund.
- The main objective of this fund is capitalappreciation.

- The whole fund is available for the entire duration of scheme and there will not be redemption demands before its maturity. Hence, the fund manager can manage the investment efficiently and profitably without the necessity of maintaining any liquidity.
- At the time of redemption, the entire investment pertaining to a close – ended scheme is liquidated and the proceeds are distributed among the unitholders.
- From the investors' point of view, it may attract more tax since the entire capital appreciation is realized in at one stage itself.
- If the market condition is not favourable, it may also affect the investor since he may not get the full benefit of capital appreciation in the value of the investment.
- Generally, the prices of close-ended scheme units are quoted at a discount of up to 40 per cent below their net asset value.

2. OPEN-ENDED FUNDS

It is just the opposite of close ended funds. Under this scheme, the size of the fund and /or the period of the fund are not predetermined. The investors are free to buy and sell any number of units at any point of time. For instance, the unit scheme 1964 of the unit trust of India is an open-ended one, both in terms of period and target amount .anybody can buy this unit at any time and sell it also at any time at his discretion.

The main features of open-ended funds are:

- There is complete flexibility with regards to one's investment or disinvestment. In other words, there free entry and exit of investors in open ended funds. There is no time limit. The investor can join in and come out from the fund as and when he desires.
- These units are not publicly traded but the fund is ready to repurchase them and resell anytime.
- The investor is offered instant liquidity in the sense that the unit can be sold on any working day. In fact, the fund operates just like a bank account, wherein one can get cash across the counter for any number of units sold.
- The main objective of this fund is income generation. The investors get dividend, right or bonuses as rewards for their investment.

- Since the unit are not listed on the stock market, there prices are linked to the net asset value of the units. The NAV is determined by the fund and it varies from time totime.
- Generally, the listed prices are very close to their net asset value .the fund fixes a different price for their purchase andsales.
- The fund manager has to be very careful in managing the investment because he has to meet the redemption demands at any time made during the life of thescheme.

ON THE BASIS OF YIELD AND INVESTMENT PLAN

1. INCOMEFUNDS

As the name suggest , this fund aims at generating and distributing regular income to the members on a periodical basis .it concentrate more on the distribution of regular income and it also sees that the average return is higher than that of income from bank deposit.

The main features are:

- The investor is assured of regular income at periodic interval, say half yearly or yearly and soon.
- The objective of this type of fund is to declare regular dividend and not capital appreciation.
- The pattern of investment is oriented towards high and fixed income yielding securities like debentures, bonds,etc.
- This is best suited to the old and retired people who may not have any regularincome.
- It concerns itself with short run gainonly.

2. PURE GROWTH ORIENTED FUNDS

Unlike the income funds, growth funds concentrate mainly on long run gains, i.e., capital appreciation. They do not offer regular income and they aim at capital appreciation in the long run. Hence, they have been described as ‘nest eggs’ investments.

The main features are:

- The growth oriented funds aims at meeting the investors need for capitalappreciation.

- The investment strategy, therefore, confirms to the fund objective by investing the fund predominantly on equities with high growth potential.
- The fund tries to get capital appreciation by taking much risk and investing on risk bearing equities and high growth equity shares.
- The fund may declare dividend, but its principle objective is only capital appreciation.
- This is best suited to salaried and business people who have high risk bearing capacity and ability to differ liquidity. They can accumulate wealth for future needs.

3. BALANCED FUNDS

This is otherwise called “income-cum-growth” fund. It is nothing but a combination of both income and growth funds. It aims at distributing regular income as well as capital appreciation. This is achieved by balancing the investments between the high growth equity shares and also the fixed income-earning securities.

4. SPECIALISED FUNDS

These funds offer special schemes so as to meet the specific needs of specific categories of people like pensioners, widows, etc. There are also funds for investments in securities of specified areas.

5. MONEY MARKET MUTUAL FUNDS (MMMFs)

These funds are basically open-ended mutual funds. But, they invest in highly liquid and safe securities like commercial paper, bankers’ acceptances, certificates of deposits, treasury bills, etc. These instruments are called money market instruments. They take the place of shares, debentures and bonds in a capital market. They pay money market rates of interest.

6. TAXATION FUNDS

A taxation fund is basically a growth-oriented fund. But, it offers tax rebates to the investors either in the domestic or foreign capital market. It is suitable to salaried people who want to enjoy tax rebates particularly during the month of February and March. In India, at present, the law relating to tax rebates is covered under sec.88 of the Income Tax Act, 1961. An investor is entitled to get 20 per cent rebate in income for investments made under this fund subject to a maximum investment of Rs. 10,000 per annum.

OTHER CLASSIFICATIONS

1. LEVERAGED FUNDS

These funds are also called borrowed funds since they are used primarily to increase the size of the value of portfolio of mutual fund. When the value increases, the earning capacity of the fund also increases.

2. DUAL FUNDS

This is a special kind of close-ended fund. It provides a single investment opportunity for two different types of investors. For this purpose, it sells two types of investment stocks, viz., income shares and capital shares. Those investors who seek current investment income can purchase income shares. They receive all the interest and dividends earned from the entire investment portfolio. The holders of capital shares receive all the capital gains earned on those shares and they are not entitled to receive any dividend of any type. In this respect, the dual fund is different from a balanced fund.

3. INDEX FUNDS

Index funds refer to those funds where the portfolios are designed in such a way that they reflect the composition of some broad-based market index. This is done by holding securities in the same proportion as the index itself. The value of these index-linked funds will automatically go up whenever the market index goes up and vice-versa.

4. BOND FUNDS

These funds have portfolios consisting mainly of fixed income securities like bonds. The main thrust of these funds is mostly on income rather than capital gains. They differ from income funds in the sense income funds offer an average returns higher than that from bank deposits and also capital gains lesser than that in equity shares.

5. AGGRESSIVE GROWTH FUNDS

These funds are just the opposite of bond funds. These funds are capital gains oriented and thus the thrust area of these funds is "capital gains". Hence, these funds are generally invested in speculative stocks. They may also use specialised investment techniques like short-term trading, option writing, etc. Naturally, these funds tend to be volatile.

6. OFF-SHORE MUTUAL FUNDS

Off-shore mutual funds are those funds which are meant for non-residential investors. In other words, the sources of investments for these funds are from abroad. So, they are regulated by the provisions of the foreign countries where those funds are registered. These funds facilitate flow of funds across different countries, with free and efficient movement of capital for investment and repatriation.

7. PROPERTY FUNDS

It is a real estate mutual fund. It is an investment vehicle which buys, develops, manages and sells real estate assets. Its investment also includes shares/ bonds of companies involved in real estate and mortgage-backed companies.

8. FUND OF FUNDS

It is a mutual fund scheme that invests in other mutual fund schemes. The concept is widely prevalent abroad.

ORGANISATION OF THE FUND

The structure of mutual fund operations in India is a three-tier establishment namely:

1. A sponsor institution to promote the fund
 2. A team of trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund, and,
 3. An Asset Management Company (AMC) to actually deal with the funds.
- a) Sponsoring institutions: The Company which sets up the mutual fund is called the sponsor. The SEBI laid down certain criteria to be met by the sponsor. The criteria mainly deal with adequate experience, good past track record, net worth, etc.
- b) Trustees: They are people with long experience and good integrity in their respective field. They carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies with the approval of SEBI.

- c) **Asset Management Company (AMC):** The AMC actually manages the funds of the various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. In fact, the success of any mutual fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control the AMC.

RISKS INVOLVED IN MUTUAL FUNDS

Mutual funds are not free from risks. It is so because basically the mutual funds also invest their funds in the stock market on shares which are volatile in nature and are not risk free. Hence the following risks are inherent in their dealings:

1. **Market Risks:** In general, there are certain risks associated with every kind of Investment on shares. They are called market risks. These market risks can be reduced, but cannot be completely eliminated even by a good investment management. The prices of shares are subject to wide price fluctuations depending upon market conditions over which nobody has a control. Moreover, every economy has to pass through a cycle –Boom, Recession, Slump and Recovery. The phase of the business cycle affects the market conditions to a larger extent.
2. **Scheme risks:** There are certain risks inherent in the scheme itself. It all depends upon the nature of the scheme. For instance, in a pure growth scheme, risks are greater. It is obvious because if one expects more returns as in the case of a growth scheme, one has to take more risks.
3. **Investment risks:** Whether the mutual fund makes money in shares or loses depends upon the investment expertise of the Asset Management Company (AMC). If the investment advice goes wrong, the fund has to suffer a lot. The investment expertise of various funds are different and it is reflected on the returns which they offer to investors.
4. **Business risks:** The corpus of a mutual fund might have been invested in a company's shares. If the business of that company suffers any setback, it cannot declare any dividend. It may even go to the extent of winding up its business. Though the mutual fund can withstand such a risk, its income paying capacity is affected.
5. **Political risks:** Successive governments bring with them new economic ideologies and policies. It is often said that many economic decisions are politically motivated. Changes

in Government bring in the risk of uncertainty which every player in the financial service industry has to face. So, mutual funds are no exception to it.

PERFORMANCE EVALUATION OF MUTUAL FUNDS

A fund manager's performance can be assessed with the help of certain benchmarks. Benchmarks are nothing but independent portfolios that are not managed by any fund manager. They are purely representative of the behaviour in market returns of selected securities. For instance, the S&P CNX Nifty is a portfolio of 50 securities traded on the National Stock Exchange. Similarly, the BSE Sensitive Index is a portfolio of 30 securities traded on the Bombay Stock Exchange. These indices and their movement to a large extent represent the movement in prices as well as returns, of large, actively traded stocks in the equity market. These independent portfolios can be used to measure the performance of a fund manager.

INVESTOR'S RIGHTS

The SEBI (MF) Regulations, 1993 contains specific provisions with regard to investor servicing. Certain rights have been guaranteed to the investors as per the above regulations. They are as follows:

1. **Unit certificates:** An investor has a right to receive his unit certificates on allotment within a period of 10 weeks from the date of closure of subscription lists in the case of a closed-ended scheme and 6 weeks from the date of closure of the initial offer in the case of an open-ended scheme.
2. **Transfer of units:** An investor is entitled to get the unit certificates transferred within a period of 30 days from the date of lodgement of the certificates along with the relevant transfer forms.
3. **Refund of application money:** If a mutual fund is not able to collect the statutory minimum amount (closed-ended funds –Rs 20 crore, open-ended funds – Rs 50 crore or 60 per cent of the targeted amounts whichever is higher), it has to return the application money as refund within a period of 6 weeks from the date of closure of subscription lists. If the refund is delayed beyond this period, each applicant is entitled to get the refund with interest at the rate of 15 per cent p.a. for the period of delay.

4. **Audited annual report:** Every mutual fund is under an obligation to its investors to publish the Audited annual report and unaudited half-yearly report through prominent newspapers in respect of each of its schemes within 6 months and 3 months respectively of the date of closure of accounts.
5. **Net Asset Value:** Again, every investor has the right to receive information about the NAV at intervals not exceeding 3 months in the case of Open-ended scheme and one month in the case of closed-ended funds. It must also be published at least in two daily newspapers.

SELECTION OF A FUND

Mutual funds are not magic institutions which can bring treasure to the millions of their investors within a short span of time. All funds are equal to start with. But in due course of time, some excel the other. It all depends on the efficiency with which the fund is being managed by the professionals of the fund. Hence, the investor has to be very careful in selecting the fund. He must take into account the following factors for evaluating the performance of any fund and then finally decide the one he has to choose:

1. **Objective of the fund:** First of all, he must see the objective of the fund – whether income-oriented or growth-oriented. Income-oriented are backed mainly by fixed interest yielding securities like debentures and bonds whereas growth-oriented are backed by equities. It is obvious that growth-oriented schemes are more risky than income-oriented schemes, and hence, the returns from such schemes are not comparable with each other. The investor should compare the particular scheme of one fund with the same scheme of another fund and make a comparative analysis. His objective should also coincide with the objective of the scheme which he proposes to choose.
2. **Consistency of Performance:** A mutual fund is always intended to give steady long term returns, and hence, the investor should measure the performance of a fund over a period of at least three years. Investors are satisfied with a fund that shows a steady and consistent performance than a fund which performs superbly in one year and then fails in the next year. Consistency in performance is a good indicator of its investment expertise.

3. **Historical background:** the success of any fund depends upon the competence of the management, its integrity, periodicity and experience. The funds integrity should be above suspicion. A good historical record could be a better horse to bet on than new funds. It is in accordance with the maxim 'A known devil is better than an unknown angel'.
4. **Cost of operation:** Mutual funds seek to do a better job of investible funds at a lower cost than the individuals could do for themselves. Hence, the prospective investor should scrutinise the expense ratio of the fund and compare it with others. Higher the ratio, lower will be the actual returns to the investor.
5. **Capacity for innovation:** The efficiency of a fund manager can be tested by means of the innovative schemes he has introduced in the market so as to meet the diverse needs of investors. An innovator will be always a successful man. It is quite natural that an investor will look for funds which are capable of introducing innovations in the financial market.
6. **Investor servicing:** The most important factor to be considered is prompt and efficient servicing. Services like quick response to investors' queries, prompt despatch of unit certificates, quick transfer of units, immediate encashment of units, etc., will go a long way in creating a lasting impression in the minds of investors.
7. **Market trends:** Traditionally, it has been found that the stock market index and the inflation rate tend to move in the same direction, whereas the interest rates and the stock market index tend to move in the opposite direction. This sets the time for the investor to enter into the fund and come out of it. A prudent investor must keep his eyes on the stock market index, interest rate and the inflation rate. Of course, there is no scientific reasoning behind it.
8. **Transparency of the fund management:** Again, the success of a mutual fund depends to a large extent on the transparency of the fund management. In these days of investor awareness, it is very vital that the fund should disclose the complete details regarding the operation of the fund. It will go a long way in creating a lasting impression in the minds of the investors to patronise the fund forever.

In fact, the wider range of products/services offered by the different funds, have made the investor quality conscious. He is now in a position to assess the quality of the products offered by MF'S in the financial market. MF'S cannot simply attract savings by mere

lucrative advertisements. The cult of the equity has spread to many small investors who have become very discerning in selecting mutual funds.

REASONS FOR SLOW GROWTH OF MUTUAL FUNDS IN INDIA

Of late, mutual funds find their going very tough. Most of the funds are not able to collect the targeted amount from small investors. Investors tend to keep out of the new issue mutual funds and they prefer to buy units from the secondary market even by paying a brokerage fee of 3 per cent. The mutual fund industry has to face many problems also, some of them are:

1. **Disparity between NAV and listed price:** Small investors are really bewildered at the lack of proper pricing for their units. Though the NAV seems to be good, the listed prices are awfully poor. Of course, the NAV is used as a parameter to rate the performance of the mutual funds. However, in practice, almost all the mutual fund schemes are deeply discounted to their NAV by as much as 30 to 40 per cent. Thus, the real dilemma for the investor is this disparity between the NAV and the listed price. Due to this factor, investors are not able to dispose of their units in the market and hence there is no liquidity at all. As on 30.9.95, nearly 23 funds were traded at a discount to their NAV ranging from 5 per cent to 35 percent.
2. **No uniformity in the calculation of NAV:** It is interesting to note that there is no standard formula for the calculation of the NAV. With the result, different companies apply different formula, and hence, any fruitful comparison of one fund with another is not at all possible. Hence, small investors cannot form a concrete opinion on the performance of different funds.
3. **Lack of transparency:** Mutual funds in India are not providing adequate information and materials to the investors. It was expected that they would provide a detailed investment pattern of their various schemes. They would also have frequent and continuing communications with the unit holders. Unfortunately, most of the funds are not able to send even quarterly report to their members. For the success of mutual funds, it is very essential that they should create a good rapport with the investors by declaring their entire holdings to them.
4. **Poor investor servicing:** Mutual funds have failed to build up investor confidence by rendering poor services. Due to the recurring transfer problems and non-receipt of dividend time, people are hesitant to touch the mutual fund scrip. Instances are there

where people have to wait for more than six months to get their unit certificates. Again, the percentage of units under objection with the fund is a so very high ranging between 3 per cent and 10 per cent. It is also said that the fake certificates are also very high. This deteriorated after sales service to the investors has positively affected the growth of this industry. Many investors have been driven out of this mutual fund industry due to this poor servicing. In the case of a company, there is a statutory obligation to convene the meeting of the shareholders and place before them important matters for discussion. There is no such meeting in the case of a mutual fund company.

5. **Too much dependence on outside agencies:** In India, most of the funds depend upon outside agencies to collect data and to do research. There is no doubt that research-driven funds can ensure good returns to its members. But, one should not rely on borrowed research. Since research involves a lot of money, mutual funds think that their overhead cost will go up and thereby their administrative expenses will go beyond the 3 per cent level fixed by the SEBI. In practice, it may not be so. In fact, they have to pay more for borrowed research and even that cannot be fully relied upon. Unless they set up their own research cell, they cannot succeed in the business.
6. **Investors' psychology:** Investors often compare units with that of shares and expect a high listing price. They don't realise that unit is a low-risk long-term instrument. Indeed, mutual funds are only for those who have the patience to wait for a long period say 3 to 5 years. But, in practice, people don't have the patience. Hence, units are not popular among the public.
7. **Absence of qualified sales force:** Efficient management of a fund requires expertise knowledge in portfolio management and skill in execution. Without professional agents and intermediaries, it cannot be managed efficiently. Unfortunately, such professional people are rare. One can find a network of qualified brokers to deal in shares and stocks. Such persons are conspicuously absent in the mutual fund industry and this absence of large and qualified sales force makes the industry suffer a setback.
8. **Other reasons:** Few funds which have not performed well have actually demoralised the investing public. Moreover, the listing of closed-ended funds on the stock exchanges has compelled the medium and small investors to go back to the stock market and face the hassles and headaches of its dealing. Above all, there is a lack of investor education in the country. Most of the investors are not aware of the mutual fund industry and the various products offered by it.

FINANCIAL MARKETS AND SERVICES

CHAPTER 5

RECENT TREND IN FINANCIAL SERVICES

PERSONALISED BANKING

Personalised financial and banking services are traditionally offered to a bank's rich, high net worth individuals (HNWIs). For wealth management purposes, HNWIs have accrued far more wealth than the average person, and therefore have the means to access a larger variety of conventional and alternative investments. Private Banks aim to match such individuals with the most appropriate options.

ATM

An automated or automatic teller machine (ATM) a cash machine, is a computerized telecommunications device that enables the clients of a financial institution to perform financial transactions without the need for a cashier, human clerk or bank teller. ATMs are known by various other names including ATM machine, automated banking machine and various regional variants derived from trademarks on ATM systems held by particular banks.

On most modern ATMs, the customer is identified by inserting a plastic ATM card with a magnetic stripe or a plastic smart card with a chip that contains a unique card number and some security information such as an expiration date. Authentication is provided by the customer entering a personal identification number (PIN).

Using an ATM, customers can access their bank accounts in order to make cash withdrawals, debit card cash advances, and check their account balances as well as purchase pre-paid mobile phone credit. If the currency being withdrawn from the ATM is different from that which the bank account is denominated in (e.g.: Withdrawing Japanese Yen from a bank account containing US Dollars), the money will be converted at an official wholesale exchange rate. Thus, ATMs often provide one of the best possible official exchange rates for foreign travelers, and are also widely used for this purpose.

TELE-BANKING AND E-BANKING

Telephone banking is a service provided by a bank or other financial institution, that enables customers to perform financial transactions over the telephone, without the need to visit a bank branch or automated teller machine. Telephone banking times can be longer than branch opening times, and some financial institutions offer the service on a 24 hour basis. From the bank's point of view, telephone banking reduces the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal and deposit transactions.

Operation

To use a financial institution's telephone banking facility, a customer must first register with the institution for the service, and set up some password (under various names) for customer verification.

To access telephone banking, the customer would call the special phone number set up by the financial institution. The service can be provided using an automated system, using speech recognition and DTMF technology or by live customer service representatives.

The types of financial transactions which a customer may transact through telephone banking include obtaining account balances and list of latest transactions,

Electronic bill payments, Funds transfers between a customer's or another's accounts. Cash withdrawals and deposits require the customer to visit an automated teller machine or bank branch.

Authentication

The password for telephone banking is normally not the same as for online banking. Financial institutions routinely allocate customer numbers (also under various names), whether or not customers intend to access their telephone or online banking facility. Customer numbers are normally not the same as account numbers, because a number of accounts can be linked to the one customer number. Customer numbers are also not the same as any card number which may have been issued to the customer by the financial institution. The customer will link to the customer number any of those accounts which the customer

controls, which may be cheque, savings, loan, credit card and other accounts. Some financial institutions have restrictions on which accounts may be access via telephone banking.

E-banking

The provision of banking service through electronic channels and the customer can access the data without time and geographical limitation.

Different services provided under e-banking:

- Online billpayment
- Shopping
- Ticketbooking
- Pre paid mobilerecharge
- Marketwatch
- Personal homepage
- Investmentservices
- Onlineapplications
- Personalupdate

Advantages of e-banking

1. Benefits forBanks

Benefits for Banks Larger customer coverage reducing the costs of operations, promoting their services and products internationally increasing the customer satisfaction and providing a personalized relationship with customers

2. Benefits for Small to MediumBusinesses

Benefits for Small to Medium Businesses to run its operations more effectively Lower cost than traditional financial management mechanisms

3. Benefits forCustomers

Benefits for Customers Convenience 24 hours a day, seven days a week Cost Reducing transfer fees Speed Faster circulation of assets Competitiveness - Fostering competition in financial market

4. Benefits for Customers

Benefits for Customers Communication communicate easily Environmental abolishing the uses of paper others - Offering one-stop-shop solutions

Disadvantages of e-banking

1. Security Risk

Security Risk increasing number of fraudulent bank websites Fake emails purporting to be sent from banks Use of Trojan Horse programs to capture user IDs and passwords

2. Fraudulent Bank Websites

Fraudulent Bank Websites A suspicious bank website: www.sbionline.com Original bank website www.onlinesbi.com these website are believed to aim to trick persons into disclosing their sensitive personal information

3. Fake e-mails

Fake e-mails Email send from fraudulent bank Verify the personal information Guide customer enter the fraud link disclosing their ATM card numbers and their passwords

4. Viruses and Worms-Trojan Horse Program

Viruses and Worms-Trojan Horse Program When we open some suspicious websites or email Trojan Horse Program will install our computer secretly Hidden in the computer When you access bank websites Capture our account and the password

CREDIT AND DEBIT CARD

Debit card

Debit card is a plastic card which provides an alternative payment method to cash when making purchases.

Functionally, it can be called an electronic check, as the funds are withdrawn directly from either the bank account or from the remaining balance on the card.

It is also known as BANK CARD or CHECK CARD.

Debit cards can also allow for instant withdrawal of cash, acting as the ATM card for withdrawing cash and as a cheque guarantee card. Merchants can also offer "cash back"/"cash out" facilities to customers, where a customer can withdraw cash along with their purchase.

Uses of debit card

- It is used instead of a check to make purchases, anywhere Visa is accepted
- It is used instead of a credit card to pay bills such as utilities, insurance and car payments
- Point-of-sale funds are drawn from primary checking account
- PIN-system security
- Change your PIN at any Merchants Bank branch
- No annual fee
- Choose from three card designs

Types of debit card

1. Online debit card
2. Offline debit card
3. Prepaid debit card
4. Electronic purse card
5. Cards for mail, telephone & internet use only

1. Online debit card

Online debit cards require electronic authorization of every transaction. The debits are reflected in the user's account immediately. The transaction may be additionally secured with the personal identification number (PIN) authentication system and some online cards require such authentication for every transaction, essentially becoming enhanced automatic teller machine (ATM) cards. One difficulty in using online debit cards is the necessity of an electronic authorization device at the point of sale (POS) and sometimes also a separate PIN

pad to enter the PIN, although this is becoming common place for all card transactions in many countries.

Banks in some countries, such as Canada and Brazil, only issue online debit cards. In the United Kingdom, Solo and Visa Electron are examples of online debit cards, which are typically issued by banks to customers whom the bank does not want to go overdrawn under any circumstances, for example under-18s.

2. Offline debit card

Offline debit cards have the logos of major credit cards or major debit cards and are used at the point of sale like a credit card. This type of debit card may be subject to a daily limit, and/or a maximum limit equal to the current/checking account balance from which it draws funds. Transactions conducted with offline debit cards require 2–3 days to be reflected on users' account balances.

In the United Kingdom, Maestro (formerly Switch) and Visa Debit (formerly Delta) are examples of offline debit cards.

3. Prepaid debitcard

Prepaid debit cards, also called reloadable debit cards or reloadable prepaid cards, are often used for recurring payments. The payer loads funds to the cardholder's card account. Particularly for US-based companies with a large number of payment recipients abroad, prepaid debit cards allow the delivery of international payments without the delays and fees associated with international checks and bank transfers.

4. Electronic purse card

Smart-card-based electronic purse systems (in which value is stored on the card chip, not in an externally recorded account, so that machines accepting the card need no network connectivity) were tried throughout Europe from the mid-1990s, most notably in Germany.

5. Cards for mail telephone and internet use only

Special pre-paid Visa cards for Mail Order/Telephone Order (MOTO) and Internet use only are made available by a small number of banks. They are sometimes called "virtual Visa cards", although they usually do exist in the form of plastic. An example is 3V.

Such a card prevents fraud by a card number thief even if the card is not blocked, because the customer normally does not store any money on the sub-account and fraudulent transactions do not get authorized by the bank

Advantages

1. A consumer who is not credit worthy and may find it difficult or impossible to obtain a credit card can more easily obtain a debit card.
2. Use of a debit card is limited to the existing funds in the account to which it is linked.
3. For most transactions, a check card can be used to avoid check writing altogether.
4. Like credit cards, debit cards are accepted by merchants with less identification.
5. Unlike a credit card, which charges higher fees and interest rates when a cash advance is obtained, a debit card may be used to obtain cash from an ATM or a PIN-based transaction at no extra charge, other than a foreign ATM fee.

Disadvantages

1. Some banks are now charging over-limit fees or non-sufficient funds fees based upon pre-authorizations.
2. Many merchants mistakenly believe that amounts owed can be "taken" from a customer's account after a debit card (or number) has been presented.
3. In some countries debit cards offer lower levels of security protection than credit cards.

Credit card

A credit card is part of a system of payments named after the small plastic card issued to users of the system. It is a card entitling its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a

merchant or as a cash advance to the user. A credit card is different from a charge card, where a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers to 'revolve' their balance, at the cost of having interest charged. Most credit cards are issued by local banks or credit unions, and are the shape and size specified by the ISO 7810 standard.

Working process

- When a purchase is made, the credit card user agrees to pay the card issuer.
- The cardholder indicates his/her consent to pay by signing a receipt with a record of the card details and indicating the amount to be paid or by entering a Personal identification number (PIN).
- Also, many merchants now accept verbal authorizations via telephone and electronic authorization using the Internet, known as a 'Card/Cardholder Not Present' (CNP) transaction.
- Electronic verification systems allow merchants to verify that the card is valid.
- The verification is performed using a credit card payment terminal or Point of Sale (POS) system with a communications link to the merchant's acquiring bank.
- Card is obtained from a magnetic stripe or chip on the card, but is more technically an EMV card (Europay, MasterCard and VISA). i.e. VSDC – VISA, Mchip – MasterCard.

Interest charges

Credit card issuers usually waive interest charges if the balance is paid in full each month, but typically will charge full interest on the entire outstanding balance from the date of each purchase if the total balance is not paid.

Benefits to customer

Due to intense competition in credit card industry, credit card providers offer incentives such as

- Frequent flyer points
- Gift certificates

- Cash back (1% based on total purchase)
- Low interest creditcards
- Even 0% interest credit cards areavailable
- Grace period

A credit card's grace period is the time the customer has to pay the balance before interest is charged to the balance. Grace periods vary, but usually range from 20 to 40 days depending on the type of credit card and the issuing bank. If a customer is late paying the balance, finance charges will be calculated and the grace period does not apply.

Benefits to merchants

- A credit card transaction is often more secure than other forms of payment, such as checks, because the issuing bank commits to pay the merchant the moment the transaction is authorized, regardless of whether the consumer defaults on the credit cardpayment.
- More secure than cash, because they discourage theft by the merchant's employees and reduce the amount of cash on thepremises.
- Prior to credit cards, each merchant had to evaluate each customer's credit history before extendingcredit.

Parties involved

1. Cardholder: Used to make apurchase.
2. Card issuing bank: The financial institution or other organization that issues the card to the cardholder.
3. Merchant: The individual or business accepting credit card payments for products or services sold to thecardholder.
4. Acquiring bank: The financial institution accepting payment for the products or services on behalf of themerchant.

TYPES OF CREDIT CARDS

1. Secured creditcards

A secured credit card is a type of credit card secured by a deposit account owned by the cardholder. Typically, the cardholder must deposit between 100% and 200% of the total amount of credit desired.

2. Prepaid “credit” cards

A prepaid credit card is not a credit card, since no credit is offered by the card issuer: the card-holder spends money which has been "stored" via a prior deposit by the cardholder or someone else, such as a parent or employer. Prepaid cards can be issued to minors (above 13) since there is no credit line involved.

3. Balance transfer creditcards

Balance transfer credit cards allow consumers to transfer a high interest credit card balance onto a credit card with a low interest rate. Typical in the market today are balance transfer credit cards with an introductory annual percentage rate (APR) of 0 percent, with that introductory or "teaser" rate lasting several months up to a year.

4. Low interest creditcards

Low interest credit cards offer either a low introductory APR that jumps to a higher rate after a certain period, or a single low fixed-rate APR. Low interest cards can be very useful when consumers need make a large purchase because it allows several months to a year to pay it off with very low or no interest.

Security

Credit card security relies on the physical security of the plastic card as well as the privacy of the credit card number. Whenever a person other than the card owner has access to the card or its number, security is potentially compromised. i.e. security PIN is required

Some merchants will accept a credit card number for in-store purchases, where upon access to the number allows easy fraud, but many require the card itself to be present, and require a signature.

Thus, a stolen card can be cancelled, and if this is done quickly, will greatly limit the fraud that can take place in this way. The PCI DSS is the security standard issued by The PCI SSC (Payment Card Industry Security Standards Council).

Credit card costs

- AnnualFees
- Interest
- Annual Percentage Rate(APR)
- Average Daily BalanceMethod
- CashAdvances
- Convenience Checks
- PenaltyRates
- Low Interest TeaserRates
- Balance Transfers
- LateFees
- Over Credit LimitFees

CUSTOMIZATION OF INVESTMENT PORTFOLIOS

Investment Counsel takes a comprehensive approach to investment management, centered on individual needs and goals. Investment Counselor will look at your wealth in its entirety, including your assets and liabilities, personal and business wealth, short-term and long-term needs and how you want your wealth to benefit others during individual lifetime and afterwards.

Portfolio management

- The art of selecting the right investment policy for the individuals in terms of minimum risk and maximum return is called as portfoliomangement.

- Portfolio management refers to managing an individual's investments in the form of bonds, shares, cash, mutual funds etc so that he earns the maximum profits within the stipulated time frame.
- Portfolio management refers to managing money of an individual under the expert guidance of portfolio managers.
- In a layman's language, the art of managing an individual's investment is called as portfolio management.

Need for portfolio management

- Portfolio management presents the best investment plan to the individuals as per their income, budget, age and ability to undertake risks.
- Portfolio management minimizes the risks involved in investing and also increases the chance of making profits.
- Portfolio managers understand the client's financial needs and suggest the best and unique investment policy for them with minimum risks involved.
- Portfolio management enables the portfolio managers to provide customized investment solutions to clients as per their needs and requirements.

Types of portfolio management

Portfolio Management is further of the following types:

- **Active Portfolio Management:** As the name suggests, in an active portfolio management service, the portfolio managers are actively involved in buying and selling of securities to ensure maximum profits to individuals.
- **Passive Portfolio Management:** In a passive portfolio management, the portfolio manager deals with a fixed portfolio designed to match the current market scenario.
- **Discretionary Portfolio management services:** In Discretionary portfolio management services, an individual authorizes a portfolio manager to take care of his financial needs on his behalf. The individual issues money to the portfolio manager who in turn takes care of all his investment needs, paperwork,

documentation, filing and so on. In discretionary portfolio management, the portfolio manager has full rights to take decisions on his client's behalf.

- Non-Discretionary Portfolio management services: In non discretionary portfolio management services, the portfolio manager can merely advise the client what is good and bad for him but the client reserves full right to take his own decisions.

Who is a Portfolio Manager?

An individual who understands the client's financial needs and designs a suitable investment plan as per his income and risk taking abilities is called a portfolio manager. A portfolio manager is one who invests on behalf of the client. A portfolio manager counsels the clients and advises him the best possible investment plan which would guarantee maximum returns to the individual. A portfolio manager must understand the client's financial goals and objectives and offer a tailor made investment solution to him. No two clients can have the same financial needs.

FINANCIAL ADVISOR

One who provides financial advice or guidance to customers for compensation. Financial advisors can provide many different services, such as investment management, income tax preparation and estate planning. Financial advisers provide advice to individuals and small companies to help them to make decisions in areas such as:

- Investments
- Loans, credit and debt reduction
- Retirement planning
- Insurance
- Estate planning (wills and trusts)
- Cash management

Getting financial advice can help you to make good investment decisions and to reach your financial goals. It is important when choosing a financial adviser to ensure that you will receive advice suited to your personal situation and lifestyle

There are two types of financial advisors:

Registered financial advisor

Registered Financial Advisors are required to be registered but does not need to be authorised by the Securities Commission because they only provide limited services. They must belong to a disputes resolutionscheme.

A person can go to a registered financial adviser for advice about simple financial products such as:

- Bank termdeposits
- Bonusbonds
- Call debtsecurities
- Call building societyshares
- Call credit unionshares
- Shares in co-operativecompanies
- Consumer credit contracts
- A unit in a cash or term portfolio investmententity
- Insurance contracts, (except investment-linked insurancecontracts)
- Life insurance policies issued before 1st January2009.

Authorised financial advisor

Authorised financial advisers must be registered and belong to a disputes resolution scheme and also be licensed by the Securities Commission. Only authorized financial advisers can give advice about complex financial products such as:

- Securities
- Land investment products
- Futures contracts
- Investment-linked insurance contracts.

An authorized financial adviser is required to attain a minimum level of competence set by the Securities Commission and must comply with the Code of Professional Conduct which sets minimum standards of client care and ethical behavior.

