Banking Industry in India

- Banking in India, in the modern sense, originated in the last decades of the 18th century.
- The first bank was the Bank of Hindustan, which was established in 1770 and liquidated in 1829-32; and the second one was the General Bank of India, established in 1786 but failed in 1791.
- The largest bank, and the oldest still in existence, is the State Bank of India (S.B.I.) originated with the merger of three presidency banks i.e. Bank of Bengal, Bank of Bombay and Bank of Madras.
- Bank of Calcutta was originated on 2nd June, 1806.
- On 2nd January, 1809, it was renamed as the Bank of Bengal.

- Bank of Bombay was originated on 15th April, 1840.
- Bank of Madras was originated on 1st July, 1843.
- The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955.
- For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934.

- In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959.
- These were called its associate banks. Now all the associate banks are merged with SBI.
- In 1969 the Indian Government nationalised 14 major private banks.
- In 1980, 6 more private banks were nationalised.
- The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks.
- The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934.

- The scheduled banks are further classified into:

a. Nationalised banks;
b. State Bank of India and its associates;
c. Regional Rural Banks (RRBs);
d. Foreign banks; and
e. Other Indian private sector banks.

- The term commercial banks refers to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949.

Commercial banking

- Bank is an institution which collects money from those who have in spare or who are saving it out of their income.
- Bank also lend this money out to those who require it.
- All those institutions which are in the business of banking are called financial institutions.

- Commercial Banks are like other financial institutions (e.g.: money lenders, indigenous bankers, cooperative societies, agricultural and industrial credit institutions) which are in the business of lending and borrowing of money or credit.
- Commercial Banks are the most important credit institutions in the country in the business of lending and borrowing of money and credit creation.

Functions of Commercial Banks

1. Accepting deposits
2. Advancing Loans
3. Discounting Bills of exchange
4. Agency services
5. General services

Functions of Commercial Banks

1. Accepting deposits:

a. Demand or Current Account Deposits:

- A depositor can withdraw it in part or in full at any time he likes without notice.
- It carries no interest.
- Only small savings of businessmen.
- Cheque facilities available.

b. <u>Fixed Deposits or Time Deposits:</u>

- Fixed deposits for 7 days to 10 years.
- Withdrawn at expiry of term.
- High rate of interest.
- A source of investment.

c. <u>Saving Bank Deposits:</u>

- Small saving deposits.
- Salaried people and other citizens.
- Less rate of interest.
- Money can be withdrawn through cheques.

d. **Recurring Deposits:**

- Recurring Deposit is a special kind of Term Deposit offered by banks in India.
- It helps people with regular incomes to deposit a fixed amount every month.
- Interest rate is same as applicable to Fixed Deposits.

2. Advancing Loans:

- This is the most important means of earnings for the banks.
- It gives loans to all the parties as required as well as possibilities and requirements.
- It keeps a fine balance between deposits and loans.
- Its profitability depends on this as well.

Two Ways of Advancing Loans

a. Overdraft Facility:

- A kind of credit facility given against current account to businessmen.
- By allowing such facility cheques are honoured even if deposits in account is less.
- Interest is charged on overdraft amount.

b. Loans by creating a deposit:

- Banks give loans to people by charging interest.
- Bank asks for security.
- Simply opens an account in name of needy person and issues a cheque book to transact.

3. Discounting Bills of Exchange:

- If a seller sells some goods to a buyer who does not pay in cash normally bills of exchange occurs.
- Seller/Drawer draws a bill of exchange which is signed by buyer/drawee.
- There is maturity or payment period with 3 days of grace.
- Now the seller can give this exchange bill to a bank which will give him cash against it.
- Bank charges interest on it to pay money before maturity.

4. Agency Services:

- Collection of bills, cheques.
- Collection of dividends, interest, premium.
- Purchase and sale of shares and debentures.
- Payment of insurance premiums.
- Acts as trustee when nominated.

5. General Services:

- Traveller’s cheques, bank draft.
- Credit Card.
- Safe vaults for valuables.
- Cash-credit limit.
- Supplying trade information.
- Money on call.
- Economic surveys.
- Projects report preparation

Banking Sector Reforms

First Phase of Reforms of Banking Sector:

On the recommendations of Narasimhan Committee, following measures were undertaken by Government since 1991:

1. Lowering SLR and CRR:

- The high SLR and CRR reduced the profits of the banks. The SLR has been reduced from 38.5% in 1991 to 25% in 1997. This has left more funds with banks for allocation to agriculture, industry, trade etc.
- The current SLR is 18.5%.
- The Cash Reserve Ratio (CRR) is the cash ratio of a banks total deposits to be maintained with RBI. The CRR has been brought down from 15% in 1991 to 4.1% in June 2003. The purpose is to release the funds locked up with RBI.
- The current CRR is 4%.

2. Prudential Norms:

- Prudential norms have been started by RBI in order to impart **professionalism in commercial banks.**
- The purpose of prudential norms include **proper disclosure of income, classification of assets and provision for bad debts** so as to ensure that the books of commercial banks reflect the accurate and correct picture of financial position.
- Prudential norms required banks to make 100% provision for all Non-performing Assets (NPAs).

3. Capital Adequacy Norms (CAN):

- Capital Adequacy ratio is the ratio of minimum capital to risk asset ratio.
- In April 1992 RBI fixed CAN at 8%.
- By March 1996, all public sector banks had attained the ratio of 8%.
- It was also attained by foreign banks.

4. De-regulation of Interest Rates:

- The Narasimhan Committee advocated that **interest rates should be allowed to be determined by market forces.**
- Since 1992, interest rates has become much simpler and freer.
- Scheduled Commercial banks have now the freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates.
- Interest rate on domestic term deposits has been decontrolled.
- The interest rates on deposits and advances of all banks have been de-regulated subject to a maximum lending rate of 13%.

5. Recovery Of Debts:

- The Government of India passed the "Recovery of debts due to Banks and Financial Institutions Act 1993" in order to facilitate and speed up the recovery of debts due to banks and financial institutions.
- Six Special Recovery Tribunals have been set up.
- An Appellate Tribunal has also been set up in Mumbai.

6. Competition From New Private Sector Banks:

- Now banking is open to private sector.
- New private sector banks have already started functioning.
- These new private sector banks are allowed to raise capital contribution from **foreign institutional investors up to 20% and from NRIs up to 40%.**
- This has led to increased competition.

7. Phasing Out Of Directed Credit:

- The committee suggested phasing out of the directed credit programme.
- It suggested that **credit target for priority sector should be reduced to 10% from 40%.**
- It would not be easy for government as farmers, small industrialists and transporters have powerful lobbies.

8. Access To Capital Market:

- The Banking Companies (Acquisition and Transfer of Undertakings) Act was amended to enable the banks to raise capital through public issues.
- This is subject to provision that the holding of Central Government would not fall below 51% of paid-up-capital.
- SBI has already raised substantial amount of funds through equity and bonds.

9. Freedom Of Operation:

- Scheduled Commercial Banks are given **freedom to open new branches and upgrade extension counters**, after attaining capital adequacy ratio and prudential accounting norms.
- **The banks are also permitted to close non-survived branches other than in rural areas.**

10. Local Area banks (LABs):

- In 1996, RBI issued guidelines for setting up of Local Area Banks and it gave its approval for setting up of 7 LABs in private sector.
- LABs will help in mobilizing rural savings and in channeling them in to investment in local areas.

11. Supervision of Commercial Banks:

- The RBI has set up a Board of Financial Supervision with an advisory council to strengthen the supervision of banks and financial institutions.
- In 1993, RBI established a new department known as Department of Supervision as an independent unit for supervision of commercial banks.

Second Phase of Reforms of Banking Sector (1998)/ Narasimhan Committee Report 1998:

On the recommendations of committee following reforms have been taken:

1. **New Areas:**

- New areas for bank financing have been opened up, such as- **Insurance, credit cards, asset management, leasing, gold banking, investment banking**, etc.

2. **New Instruments:**

- For greater flexibility and better risk management new instruments have been introduced such as- **Cross currency forward contracts, Forward rate agreements, Liquidity adjustment facility for meeting day-to-day liquidity mis-match**.

3. **Risk Management:**

- Banks have started specialized committees to measure and monitor various risks.
- They are regularly upgrading their skills and systems.

4. **Strengthening Technology:**

- For payment and settlement system technology infrastructure has been strengthened with **electronic funds transfer, centralized fund management system**, etc.

5. **Increase Inflow Of Credit:**

- Measures are taken to increase the flow of credit to priority sector through focus on **Micro Credit and Self Help Groups.**

6. **Increase in FDI Limit:**

- In private banks the limit for FDI has been increased from 49% to 74%.

7. **Universal Banking:**

- Universal banking refers to combination of commercial banking and investment banking.

8. **Adoption Of Global Standards:**

- RBI has introduced Risk Based Supervision of banks.
- Best international practices in accounting systems i.e. **corporate governance, payment and settlement systems** etc. are being adopted.

9. **Information Technology:**

- Banks have introduced **online banking, E-banking, telephone banking** etc.
- Measures have been taken to facilitate delivery of banking services through electronic channels.

10. **Management of NPAs:**

- RBI and Central Government have taken measures for management of non-performing assets (NPAs), such as Debt Recovery Tribunals (DRTs) and Lok Adalts.

11. Mergers And Amalgamation:

- In May 2005, RBI has issued guidelines for merger and Amalgamation of private sector banks.

12. Guidelines For Anti-Money Laundering:

- In recent times, prevention of money laundering has been given importance in international financial relationships.
- In 2004, RBI revised the guidelines on know your customer (KYC) principles.

13. Managerial Autonomy:

- In February, 2005 the Government of India has issued a managerial autonomy package for public sector banks to provide them a level playing field with private sector banks in India.

14. Customer Service:

- In recent years, to improve customer service, RBI has taken many steps such as- **Credit Card Facilities, settlement off claims of deceased depositors**, etc

15. Base Rate System Of Interest Rates:

- In 2003 the system of Benchmark Prime Lending Rate (BPLR) was introduced to serve as a benchmark rate for banks pricing of their loan products so as to ensure that it truly reflected the actual cost.
- RBI introduced the system of Base Rate since 1st July, 2010.
- The base rate is the minimum rate for all loans.
- The current base rate is 8.95%

Reserve Bank of India

- The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.
- The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937.
- The Central Office is where the Governor sits and where policies are formulated.
- Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble

- The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

a. To regulate the issue of Bank notes.
b. To keep of reserves with a view to secure monetary stability in India.
c. To generally operate the currency and credit system of the country.
d. To have a modern monetary policy framework.
e. To meet the challenge of an increasingly complex economy.
f. To maintain price stability while keeping in mind the objective of growth.

Central Board

- The Reserve Bank's affairs are governed by a central board of directors.
- The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.
- Appointed/nominated for a period of four years.

Constitution

a. **Official Directors:**

- Full-time: Governor and not more than four Deputy Governors

a. **Non-Official Directors:**

- Nominated by Government: ten Directors from various fields and two government Official
- Others: four Directors - one each from four local boards

NABARD

INTRODUCTION

- NABARD is set up as an apex Development Bank with a mandate for facilitating credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts.
- It also has the mandate to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure prosperity of rural areas.

HISTORY

- The Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD), set up by the Reserve Bank of India (RBI) under the Chairmanship of SHRI B. SIVARAMAN, conceived and recommended the establishment of the National Bank for Agriculture and Rural Development (NABARD).
- It was established on 12th July,1982 by a special act of parliament and its main focus was to uplift rural India by increasing the credit flow for development of agriculture.

MICRO FINANCE

- **Vision:**
- Empowerment of rural poor by improving their access to the formal credit system through various micro finance innovations in a cost effective and sustainable manner.
- **Mission:**
- Promoting sustainable and equitable agriculture and rural development through effective credit support, related services, institution building and other innovative initiatives.

ORGANISATION STRUCTURE

OBJECTIVES

- It is an apex organization in respect of all matters relating to policy, planning operational aspects in the field of credit for promotion of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts.
- It will also provide direct lending to any institution as may approved by the Central Government.
- It will have organic links with the Reserve Bank and maintain a close link within.
- It will serve as a re-financing institution for institutional credit such as long-term, short-term for the promotion of activities in the rural areas.

ROLES AND FUNCTIONS

- Credit Functions.
- Developmental and Promotional Functions.
- Supervisory Functions.
- Institutional and Capacity building.
- Role in Training.

CREDIT FUNCTIONS

- Framing policy and guidelines for rural financial institutions.
- Providing credit facilities to issuing organizations.
- Monitoring the flow of ground level rural credit.

DEVELOPMENT AND PROMOTIONAL FUNCTIONS

- Help co-operative banks and Regional Rural Banks to prepare development actions plans for themselves.
- Monitor implementation of development action plans of banks and fulfillment of obligations under MoUs.
- Provide financial support for the training institutes of co-operative banks.

SUPERVISORY FUNCTIONS

- Undertakes inspection of Regional Rural Banks (RRBs) and Cooperative Banks (other than urban/primary cooperative banks) under the provisions of Banking Regulation Act,1949.
- Undertakes inspection of State Cooperative Agriculture and Rural Development Banks (SCARDBs) and apex non-credit cooperative societies on a voluntary basis.

INSTITUTIONAL AND CAPACITY BUILDING

- Help co-operative banks and RRBs to prepare development actions plans for themselves.
- Monitor implementation of development action plans of banks and fulfillment of obligations under MOUs.
- Provide financial assistance to cooperatives and RRBs for establishment of technical, monitoring and evaluations cells.
- Provide organization development intervention (ODI) through reputed training institutes like Bankers Institute of Rural Development (BIRD), Lucknow, National Bank Staff College, Lucknow, College of Agriculture Banking, Pune, etc.
- Provide financial support for the training institutes of co-operative banks.
- Provide training for senior and middle level executives of commercial banks, RRBs and cooperative banks.

ROLE OF TRAINING

- Section 38 of the NABARD Act provides that the Bank shall:
- Maintain expert staff to study all problems relating to agriculture and rural development and be available for consultation to the central government, the reserve bank, the state governments and the other institutions engaged in the field of rural development.
- Provide facilities for training, for dissemination of information and the promotion of research including the undertaking of studies, researches, techno-economic and other surveys in the field of rural banking, agriculture and rural development.
- May provide consultancy services in the field of agriculture and rural development.
- The role of training in NABARD and the role played by it for capacity building in client institutions, partner agencies and other developmental agencies is important.

BANKING SERVICES

- Production credit
- Kisan Credit Cards
- Farmers' Club Program
- Tribal Development Fund
- Micro-finance Program
- Village Development Program
- Farm Innovation and Promotion Fund
- Rural Infrastructure Development Fund

EXIM BANK

INTRODUCTION

- It was set up by an act of parliament in September, 1981.
- It is wholly owned by the Government of India.
- It was commenced operations in March,1982.
- Since its inception, Exim Bank of India has been both a catalyst and a key player in the promotion of cross border trade and investment.
- It includes import of technology and export product development, export production, export marketing, pre-shipment, post-shipment and overseas investment.

OBJECTIVES

- It provides financial assistance to exporters and importers.
- Its functioning as the principal financial institution for co-ordinating the working of institutions engaged in financing export and import of goods and services with a view to promoting the country's international trade.
- It shall act on business principles with due regard to public interest.
- It develops commercially viable relationships with a target set of externally oriented companies through a comprehensive range of products and services.
- It aimed at enhancing their internationalisation efforts.
- Its mission is to facilitate globalisation of Indian business.

LEADERSHIP

- Shri. R.C. Shah was the first Chairman and Managing Director (CMD) from 1982 - 1985.
- Shri. Kalyan Banerji succeeded him from 1985 – 1993.
- Ms. Tarjani Vakil led the Bank from 1993 – 1996. She was the first women to head a financial institution in India.
- Shri. Y.B. Desai, Shri. T.C. Venkat Subramaniyan and Smt. Ravneet Kaur, as Joint Secretary, Department of Financial Services, Ministry of Finance, held the reins from 1997 - 2001, 2001 - 2009 and 2009 - 2010 respectively.

- Shri. T.C.A. Ranganathan took charge to implement mission-driven organisational changes till 2013.
- Shri. Anurag Jain, Joint Secretary, Department of Financial Services, Ministry of Finance held the interim charge of CMD till early 2014.
- Shri Yaduvendra Mathur, IAS, took charge as Chairman & Managing Director of the Bank for a tenure of three years, from February 2014 to February 2017.
- Shri David Rasquinha was appointed the Managing Director of Exim Bank from August 2017.

MANAGEMENT

BOARD OF DIRECTORS (16)

- Chairman and Managing Director
- 5 Directors: Government of India
- 3 Directors: Scheduled Banks
- 4 Directors : Professionals/Experts
- 1 Director nominated by RBI
- 1 Director nominated by IDBI
- 1 Director nominated by ECGC

Appointed
by
Govt. of India

Dr. Mayank Malviya

OFFICES

Domestic Offices: 10	Overseas Offices:7
▪Ahmedabad ▪Bangalore ▪Chandigarh ▪Chennai ▪Guwahati ▪Hyderabad ▪Kolkata` ▪New Delhi ▪Mumbai ▪Pune	▪Addis Ababa ▪Dakar ▪Dubai ▪Durban ▪London ▪Singapore ▪Washington DC

EXIM BANK’S COMPETITIVE ADVANTAGE

- Comprehensive range of products and services for exporters.
- Knowledge of exporters requirements.
- International experience.
- Competitive finance.
- Lending in both rupee and foreign currency.
- Foreign currency financing for SMEs.
- It provides term loan for financing soft expenditure such as marketing, product development, R&D financing.

Working Capital Finance

1. Export Finance:

- Pre-shipment Credit
- Post Shipment Credit
- Buyers' Credit
- Suppliers' Credit
- Bills Discounting
- Export Receivables Financing
- Warehousing Finance

2. General Working Capital Finance:

- Working Capital Term Loans
- Bulk Import Finance Programme

Overseas Investment Finance

- Finance for Indian Company's equity participation in the overseas Joint Venture (JV)/ Wholly Owned Subsidiary (WOS).
- Direct Finance (Term & Working Capital) to the overseas JV / WOS.
- Finance (for equity/debt component) for acquisition of overseas businesses / companies including leveraged buy-outs including structured financing options.
- Direct Equity by EXIM Bank in the overseas JV/ WOS of an Indian Company

Institutional Linkages

Multilateral Agencies	Trade & Investment Promotion Agencies	Export Credit Agencies
▪World Bank ▪Asian Development Bank ▪African Development Bank ▪European Bank for Reconstruction and Development (EBRD) ▪Multilateral Investment Guarantee Agency (MIGA) ▪International Financial Corporation (IFC) ▪United Nations Conference on Trade and Development (UNCTAD)	▪Japan External Trade Organisation (JETRO) ▪Netherlands Council for Trade Promotion ▪Polish Agency for Foreign Investment ▪Board of Investment of Sri Lanka ▪Board of Investment Mauritius	▪Exim Bank Romania ▪Czech Export Bank ▪Hungarian Exim Bank ▪Japan Bank for International Co-operation (JBIC) ▪US Exim Bank ▪Exim Bank of China

Non-banking Financial Institutions

Non-banking Financial Institutions

- A NBFI is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency.
- NBFI's are financial institutions that provide banking services but do not hold banking license.
- These institutions are not allowed to take deposits from the public.
- **Example:** Insurance firms, pawn shops, currency exchanges and microloan organizations.

Importance of NBFI’s

- Greater reach.
- Flexibility in tapping resources.
- Retail services to small and medium business.
- Important component of financial market.

Role of NBFI's

- Development of sectors like transport and infrastructure.
- Substantial employment generation.
- Help and increase wealth creation.
- Broad base economic development.
- To finance economically weaker sections.

Functions of NBFI's

- Brokers of loanable funds.
- Mobilisation of savings.
- Channelisation of funds into investment.
- Stabilise the capital market.
- Provide liquidity.

Regulations of NBFI's

- RBI Act, 1934, it is mandatory that every NBFI should be registered with RBI to commence or carry on any business of non-banking financial institution.

Power Finance Corporation

- It is an Indian financial institution, established in 1986.
- It is the financial backbone of Indian Power Sector.
- Net worth of the company in the year 2016-2017 was ₹ 36,470.21 crore.
- It was initially wholly owned by the Govt. of India.
- The company issued first IPO in January, 2007.

- The first issue was over-subscribed by 76 times, which is the largest for an IPO of any Indian Company in recent times.
- It is listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).
- The company has been granted with many prestigious awards, the latest of which is “Central Board of Irrigation and Power (CBIP) Award 2017" for its contribution in development of power sector.
- It is also an ISO 9001:2000 certified company and enjoys the status of Navratna Company in India from 22nd June, 2007.

Vision and Mission of PFC

Corporate Vision

- To be the leading institution in financing for sustainable development of Indian power sector and its linkages with an eye on global operations.

Corporate Mission

- To become the most preferred Financial Institution in power and financial sectors providing best products and services.
- To promote efficient investments in Power Sector to enable availability of required quality power at minimum cost to consumers.

- To reach out to global financial system for financing power development.
- To act as a catalyst for reforming India's Power Sector.

Structure of the Organisation

- The corporation is run by the Board of Directors which is the highest decision-making body.
- It works through a hierarchy of whole time executives and employees.
- The number of employees currently employed in managerial capacity includes:

a. Whole time Chairman and Managing Director and Directors stand at 183.

b. Non-managerial capacity stand at 129, total being 312.

Objectives of PFC

- To provide financial resources and encourage flow of investments to the power and associated sectors.
- To work as a catalyst to bring improvements in streamlining the functions of its borrowers in the areas of technical, financial and managerial to ensure optimum utilization of available resources.
- To mobilize various resources viz. domestic and international at competitive rates.
- To strive for upgradation of skills in power sector for effective and efficient growth of the sector.
- To maximize the rate of return through efficient operations and introduction of innovative financial instruments and services of the power sector.

General Documents Required for Effective Working

- Articles of Association.
- Memorandum of Association.
- Manuals developed for conducting of business and work:

a. HR manual
b. Service manual (Domestic and International)
c. Procurement manual
d. Vigilance manual
e. Investment Manual
f. Risk Management Policy etc.

- Operational Policy Statements.

UNIT-1

Capital Market:

- It is the part of a financial system concerned with raising capital by dealing in shares, debentures, bonds and other long-term investments.
- It is a market in which money is provided for periods longer than a year.
- In capital market three broad categories of suppliers of long-term funds i.e.

a. Individuals
b. Commercial Banks
c. Non-banking Financial Corporations or Institutions (insurance companies, pension, provident funds, etc.

- This market practically exist in all those countries where some industrialization has taken place.

Market of Securities:

- It is a process of approaching a large number of investors to invest their savings or funds in different security instruments like shares and debentures of the company.
- It includes the new issue and distribution of securities related to new or existing companies.
- It also include in buying and selling of old securities in stock exchange market.
- There are number of agencies and institutions in the market which help a company to newly issue as well as purchase and sale of securities.
- It can be categorized in two categories:

1. Primary Market
2. Secondary Market

Primary Market/New Issue Market:

- Market where new securities i.e. shares and bonds first time issued.
- Both the new companies and the existing ones can issue securities in this market to raise capital.
- In this market transactions are made between an issuer and the investors.
- This market is directly regulated by SEBI.
- The process of selling new issues to investors is called underwriting.
- In the case of a new stock issue, this sale is called as an Initial Public Offer (IPO).

Functions of Primary Market:

1. Origination:

- It simply means origin of the new issue.
- It is the work which begins before an issue is actually floated in the market.
- The following things is being determined before origin of issue i.e.

a. Time of floating the new issue
b. Type of issue
c. Price

2. Underwriting:

- It is a kind of guarantee undertaken by an institution or firm of brokers ensuring the marketability of an issue.
- It is a method in which the guarantor promise to the issuing company that he/she would purchase certain specific shares if the public not invested in it.
- The following organisations who give guarantee are:

a. LIC
b. GIC
c. Development Banks (IDBI, ICICI, etc.)
d. Brokers, etc.

3. <u>Distribution:</u>

- It involves the function of sale of shares and debentures to the investors.
- It is performed by brokers and agents.
- Brokers can maintain regular list of clients and directly contact for purchase and sale of securities.

Methods of Floating New Issues
OR
Methods to Raise Equity Capital in the Primary Market

1. Public Issue:

- When a company raises funds by issuing its shares, debentures and bonds to the public, it is called as a public issue.

2. Initial Public Offer (IPO):

- When a company makes a public issue for the first time and get its shares listed on stock exchange, the public issue is called as initial public offer (IPO).

3. Follow-on Public Offer (FPO):

- When a listed company makes additional public issue on running projects to raise capital, it is called follow-on public offer (FPO).

4. Offer for Sale:

- Institutional investors like venture funds, private equity funds etc., invest in unlisted company when it is very small or at an early stage.

- When the company becomes large, these investors sell their shares to the public, through issue of offer document and the company's shares are listed in stock exchange. This is called as offer for sale.

5. Private Placement:

- It is the sale of securities to a relatively small number of select investors for raising capital.
- Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds.
- Private placement is the opposite of a public issue, in which securities are made available for sale on the open market.

6. Rights Issue:

- When a company raises funds from its existing shareholders by issuing them new shares/ debentures, it is called as **rights issue**.
- The offer document for a rights issue is called as the **Letter of Offer.**
- The issue is open for 30-60 days.

7. Bonus Issue:

- The company issues new shares to its existing shareholders.
- Shareholders need not pay any money to the company for receiving the new shares.

Stock Exchange

- A stock exchange is an exchange where stockbrokers and traders can buy and/or sell stocks (also called shares), bonds and other securities.
- It is a market place where listed securities buy and sell for investment or speculation.
- It is an organised and regulated market for various securities issued by corporate sector and other institutions.
- It is a privately organised market which are used to facilitate trading of securities.
- It is as ready market where buyers and sellers are always available to buy and sell the securities.
- The securities of corporations, trusts, Government, municipal corporations, etc. are allowed to deal at stock exchange.
- It is a market wholly governed and regulated by SEBI.

Functions of Stock Exchange:

1. **Ensure Liquidity of Capital:**

- It provides a place where securities are converted into cash.
- It is a market where buyers and sellers are always available and those who need hard cash can sell their securities.

2. **Economic Barometer:**

- It is a reliable barometer to measure the economic condition of a country.
- Every major change in country is reflected in the prices of shares.
- The rise or fall in the share prices indicates the boom or recession cycle of the country.

3. Pricing of Securities:

- It helps to value the securities on the basis of demand and supply.
- The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities.
- The valuation of securities is useful for investors, government and creditors.
- The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.

4. Contributes to Economic Growth:

- In stock exchange securities of various companies are bought and sold.
- This process of investment and re-investment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

5. Spreading of Ownership Culture:

- Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

6. Providing Scope for Speculation:

- To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

7. Better Allocation of Capital:

- The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market.
- The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor's fund to profitable channels.

8. Promotes the Habits of Savings and Investment:

- The stock market offers attractive opportunities of investment in various securities.
- These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

9. Safety of Transactions:

- In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company.
- The companies which are listed they also have to operate within the strict rules and regulations.
- This ensures safety of dealing through stock exchange.

Types of Speculators:

1. Jobber:

- He/She is a professional speculator who has a complete information regarding the particular shares he/she deals.
- He/She transacts the shares of profit.
- He/She conducts the securities in his own name.
- He/She is the member of the stock exchange.
- He/She is equivalent to market maker.

2. Broker:

- He/She is a person who transact business in securities on behalf of his clients and receives commission for his services.
- He/She deals between the jobbers and members outside the house.
- He/She is an experienced agent of the public.

3. Bull:

- He/She is a speculator who purchases various types of shares.
- He/She purchases to sell them on higher prices in future.
- He/She may sell the shares and securities before coming in possession.
- If the price falls then he suffers a loss.

4. Bear :

- He/She is always in a position to dispose of securities which he does not possess.
- He/She makes profit on each transaction.
- He/She sells the various securities for the objective of taking advantages of an expected fall in prices.

5. **Stag:**

- He/She is also a speculator.
- He/She purchases the shares of **newly floated company** and shown himself a **genuine investor.**
- He/She is not willing to become an actual shareholder of the company.
- He/She purchases the shares to sell them above the par value to earn premium

Trading of Securities:

1. Equity:

- It is a term which is called as equity shares basically issued against the ownership of the business.
- It represents the ownership capital.
- It is also called as ordinary shares.
- The holders of these shares are the real owners of the company.
- They have a voting right in the meetings of holders of the company.
- They have control over the working of the company.
- The rate of dividend on these shares depends upon the profits of the company.
- Equity shareholders take risk both regarding dividend and return of capital.
- Equity share capital cannot be redeemed during the life time of the company.

Types of Equity Shares:

1. Right Share:

- These are the shares issued to the existing shareholders of a company.
- Such kind of shares is issued to protect the ownership rights of the investors.

2. Bonus Share:

- These are the type of shares given by the company to its shareholders as a dividend.

3. Sweat Equity Share:

- These shares are issued to exceptional employees or directors of the company for their exceptional job in terms of providing know-how or intellectual property rights to the company.

4. Growth Shares:

- Shares which have a fairly boom position in the growing market.
- It enjoys an average rate of growth as well as profitability.

5. Speculative Shares:

- Shares that tend to fluctuate widely because there is a lot of speculative trading in them.

6. Defensive Shares:

- Shares that are relatively unaffected of ups and downs in general business conditions.

Debentures

- It is a medium to long-term debt instrument used by large companies to borrow money, at a fixed rate of interest.
- If a company needs funds for extension and development purpose without increasing its share capital, it can borrow from the general public by issuing certificates for a fixed period of time and at a fixed rate of interest.
- Such a loan certificate is called a debenture.
- Debentures are generally freely transferable by the debenture holder.
- Debenture holders have no rights to vote in the company's general meetings of shareholders.

- Debenture holders are the creditors of the company.
- Debenture holders normally receive fixed rate of return, either business have earned profit or loss.
- Interest on debenture is a tax deductible expenditure and thus it saves income tax.
- Cost of debenture is relatively lower than preference shares and equity shares.
- Issue of debentures is advantageous during times of inflation.

Types of Debentures:

1. **Ordinary Debentures:**

- Such debentures are issued without mortgaging any asset, i.e. this is unsecured.
- It is very difficult to raise funds through ordinary debenture.

2. **Mortgage Debentures:**

- This type of debenture is issued by mortgaging an asset and debenture holders can recover their dues by selling that particular asset in case the company fails to repay the claim of debenture holders.

3. **Non-convertible Debentures:**

- A non-convertible debenture is a debenture where there is no option for its conversion into equity shares.
- Thus the debenture holders remain debenture holders till maturity.

4. Partly Convertible Debentures:

- The holders of partly convertible debentures are given an option to convert part of their debentures into equity shares.
- After conversion they will enjoy the benefit of both debenture holders as well as equity shareholders.

5. Fully Convertible Debentures:

- Fully convertible debentures are those debentures which are fully converted into specified number of equity shares after predetermined period at the option of the debenture holders.

6. Redeemable Debentures:

- Redeemable debenture is a debenture which is redeemed/repaid on a pre-determined date and at pre-determined price.

7. Irredeemable Debenture:

- Such debentures are generally not redeemed during the lifetime of the company.
- So, it is also termed as **perpetual debt**.
- Repayment of such debenture takes place at the time of liquidation of the company.

8. Registered Debentures:

- Registered debentures are those debentures where **names, address, serial number**, etc., of the debenture holders are recorded in the register book of the company.
- Such debentures cannot be easily transferred to another person.

9. Unregistered Debentures:

- Unregistered debentures may be referred to those debentures which are not recorded in the company's register book.
- Such type of debenture is also known as **bearer debenture**.
- This kind of debentures can be easily transferred to any other person.

Bonds

- A bond called as a debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing.
- It is a written and signed promise to pay a certain sum of money on a certain date i.e. on maturity, or on fulfillment of a specified condition.
- All documented contracts and loan agreements are bonds.
- Bonds normally issued on discounted value i.e. less than par value but sometimes it can be issued against some fixed interest.
- Bonds can be also called bills, notes, debt securities, or debt obligations.
- **Bills -** debt securities maturing in less than one year.
  Notes - debt securities maturing in one to 10 years.
  Bonds - debt securities maturing in more than 10 years.
- Bonds have set maturity dates that can range from one to 30 years.
- Short-term bonds (mature in three years or less), intermediate bonds (mature in three to ten years) and long-term bonds (mature in ten years or more).
- If the bond has a "call feature", the issuer i.e. the company is allowed to redeem the bond before its maturity date.

Types of Bonds

1. Zero-Coupon Bonds:

- This is a type of bond that makes no coupon payments but instead is issued at a considerable discount to par value.
- It is also called as Deep Discount bonds or Discount bonds.
- For example, let's say a zero-coupon bond with ₹1,000 par value and 10 years to maturity is trading at ₹ 600; you are paying ₹ 600 today for a bond that will be worth ₹ 1,000 in 10 years.

2. Corporate Bonds:

- It is a kind of bond issued by a company as it can issue against stock.
- A short-term corporate bond has a maturity of less than 5 years, intermediate is 5 to 12 years and long term is more than 12 years.
- It is characterized by higher yields because there is a higher risk of a company defaulting than a government.

3. Convertible Bonds:

- A convertible bond may be redeemed for a pre-determined amount of the company's equity at certain times during its life, usually at the discretion of the bondholder.
- Convertibles are sometimes called "CVs."
- The return against these bonds are received both in fixed as well as based on market risk.

4. Callable Bonds:

- Callable bonds, also known as **"redeemable bonds,"** can be redeemed by the issuer prior to maturity.
- Usually a premium is paid to the bond owner when the bond is called.
- The main cause of a call is a decline in interest rates.
- If interest rates have declined since a company first issued the bonds, it will likely want to re-finance this debt at a lower rate.
- In this case, the company will call its current bonds and reissue new, lower-interest bonds to save money.

5. Junk Bonds:

- A junk bond, also known as a "high-yield bond" or "speculative bond," is a bond rated 'BB' or lower because of its high default risk.
- **'BB' rating involves moderate risk.**
- It typically offer interest rates three to four percentage points higher than safer government issues.

Preference Shares

- Preference shares, more commonly referred to as preferred stock, are shares of a company's stock with dividends that are paid out to shareholders before common stock dividends are issued.
- Most preference shares have a fixed dividend, while common stocks generally do not.
- If the company is in a position of loss the fixed dividend can be carry forward to the next year and company can pay return of both the years.
- If the company enters bankruptcy, the shareholders with preferred stock are entitled to be paid from company assets first.
- Preferred stock shareholders also typically do not hold any voting rights of the company.

Types of Preference Shares:

1. Cumulative Preference Shares:

- When unpaid dividends on preference shares are treated as arrears and are carried forward to subsequent years, then such preference shares are known as cumulative preference shares.
- It means unpaid dividend on such shares is accumulated till it is paid off in full.

2. Non-cumulative Preference Shares:

- Non-cumulative preference shares are those type of preference shares, which have right to get fixed rate of dividend out of the profits of current year only.
- They do not carry the right to receive arrears of dividend.
- If a company fails to pay dividend in a particular year then that need not to be paid out of future profits.

3. Redeemable Preference Shares:

- Those preference shares, which can be redeemed or repaid after the expiry of a fixed period or after giving the prescribed notice as desired by the company, are known as redeemable preference shares.
- Terms of redemption are announced at the time of issue of such shares.

4. Non-redeemable Preference Shares:

- Those preference shares, which can not be redeemed during the life time of the company, are known as non-redeemable preference shares.
- The amount of such shares is paid at the time of liquidation of the company.

5. Participating Preference Shares:

- Those preference shares, which have right to participate in any surplus profit of the company after paying the equity shareholders, in addition to the fixed rate of their dividend, are called participating preference shares.

6. Non-participating Preference Shares:

- Preference shares, which have no right to participate on the surplus profit or in any surplus on liquidation of the company, are called non-participating preference shares.

7. **Convertible Preference Shares:**

- Those preference shares, which can be converted into equity shares at the option of the holders after a fixed period according to the terms and conditions of their issue, are known as convertible preference shares.

8. **Non-convertible Preference Shares:**

- Preference shares, which are not convertible into equity shares, are called non-convertible preference shares.

MONEY MARKET

- Money market refers to the market where money and highly liquid marketable securities are bought and sold having a maturity period of one or less than one year.
- It is not a place like the stock market but an activity conducted by telephone.
- The money market constitutes a very important segment of the Indian financial system.
- The highly liquid marketable securities are also called as ‘money market instruments’ like treasury bills, government securities, commercial paper, certificates of deposit, call money, repurchase agreements etc.
- **According to the Geoffrey,** “money market is the collective name given to the various firms and institutions that deal in the various grades of the near money.”

- **As per RBI definitions** " A market for short terms financial assets that are close substitute for money, facilitates the exchange of money in primary and secondary market".
- The money market is a mechanism that deals with the lending and borrowing of short term funds (less than one year).
- A segment of the financial market in which financial instruments with high liquidity and very short maturities are traded.

- It doesn't actually deal in cash or money but deals with substitute of cash like trade bills, promissory notes & Govt. papers which can converted into cash without any loss at low transaction cost.
- It includes all individual, institution and intermediaries.

Objective of Money Market

- To provide a place to invest short-term surplus funds.
- To provide possibilities to overcome short-term deficits.
- To enable the Reserve Bank of India to influence and regulate liquidity in the economy through its intervention in this market.
- To provide a reasonable access to users of short-term funds to meet their requirement quickly and adequately at reasonable cost.

Instruments of Money Market

1. Treasury bills.
2. Certificate of Deposit.
3. Commercial Papers.
4. Re-purchase Agreement.
5. Banker's Acceptance.

Treasury Bills (T-Bills)

- T-bills are the most marketable money market security.
- They are issued with three-month, six-month and maximum for less than one-year maturities (maximum 364 days).
- T-bills are purchased for a price less than their par (face) value i.e. at discounted value; when they mature, the Government pays the holder the full par value.
- T-Bills are so popular among money market instruments because of affordability to the individual investors.

Certificate of deposits (CD)

- A CD is a time deposit with a bank.
- Like most other time deposit, funds cannot withdrawn before maturity without paying a penalty.
- CD's have specific maturity date, interest rate and it can be issued in any denomination.
- The main advantage of CD is their safety.
- Anyone can earn more than a saving account interest.

Commercial Papers (CP)

- CP is a short-term unsecured loan instrument issued by a corporation typically financing day-to-day operation.
- CP is very safe investment because the financial situation of a company can easily be predicted over a few months.
- Only company with high credit rating issues CP's.
- This can be issued for longer than 270 days maximum upto one year.

Re-purchase Agreement

- It is also called as Repo Instrument.
- Repo is a form of overnight borrowing and is used by those who deal in Government securities.
- They are usually very short-term repurchases agreement, from overnight to 30 days.
- The short-term maturity and Government backing usually mean that Repos provide lenders with extremely low risk.
- Repos are safe collateral for loans.

Banker's Acceptance

- A banker’s acceptance (BA) is a short-term credit investment created by a non-financial firm.
- BA’s are guaranteed by a bank to make payment.
- Acceptances are traded at discounts from face value in the secondary market.
- BA acts as a negotiable time draft for financing imports, exports or other transactions in goods.
- This is especially useful when the credit worthiness of a foreign trade partner is unknown.

Structure of Indian Money Market

A. ORGANISED STRUCTURE:

- Reserve bank of India.
- DFHI (Discount and Finance House of India).
- State Bank of India.
- Cooperative banks.
- 20 Nationalised Banks.
- Private Indian Banks.
- Private Foreign Banks.
- IDBI, IFCI, ICICI, NABARD, LIC, GIC, UTI etc.

B. UNORGANISED SECTOR:

- Indigenous banks.
- Money lenders.
- Chits.
- Nidhis.

Securities and Exchange Board of India

- The Securities and Exchange Board of India (SEBI) is the regulator for the securities market in India.
- It was established in the year 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992.
- SEBI has its headquarters at the business district of Bandra Kurla Complex in Mumbai, and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmedabad respectively.
- It has opened **local offices at Jaipur and Bangalore.**
- SEBI is managed by its members, which consists of following:

a. The chairman who is nominated by Government of India.

b. Two members, i.e., Officers from Finance Ministry.

c. One member from the Reserve Bank of India.

d. The remaining five members are nominated by Government of India, out of them at least three shall be whole-time members.

Objectives of SEBI:

a. To regulate the activities of stock exchange.
b. To protect the rights of investors and ensuring safety to their investment.
c. To prevent fraudulent and mal-practices by having balance between self regulation of business and its statutory regulations.
d. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

Functions of SEBI:

1. SEBI checks price manipulation.
2. SEBI prohibits fraudulent and Unfair Trade Practices.
3. SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.
4. SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in mid-term.
5. SEBI promotes training of intermediaries of the securities market.
6. SEBI has permitted internet trading through registered stock brokers.
7. Even initial public offer of primary market is permitted through stock exchange.
8. SEBI registers and regulates the working of mutual funds etc.
9. SEBI regulates takeover of the companies.
10. SEBI conducts inquiries and audit of stock exchanges.

DERIVATIVES

- A derivative is a financial instrument whose value is derived from the value of another asset, which is known as the underlying.
- When the price of the underlying changes, the value of the derivative also changes.
- A derivative is not a product. It is a contract that derives its value from changes in the price of the underlying.
- **Example:**

a. The value of a gold futures contract is derived from the value of the underlying asset i.e. Gold.

Traders in Derivatives Market

1. HEDGER:

- A hedger is someone who faces risk associated with price movement of an asset and who uses derivatives as means of reducing risk.
- They provide economic balance to the market.

2. SPECULATOR:

- A trader who enters the futures market for pursuit of profits, accepting risk in the endeavor.
- They provide liquidity and depth to the market.

3. ARBITRAGEUR:

- A person who simultaneously enters into transactions in two or more markets to take advantage of the discrepancies between prices in these markets.
- Arbitrage involves making profits from relative mispricing.
- Arbitrageurs also help to make markets liquid, ensure accurate and uniform pricing, and enhance price stability.
- They help in bringing about price uniformity and discovery.

OTC

- Over-the-counter (OTC) or off-exchange trading is to trade financial instruments such as stocks, bonds, commodities or derivatives directly between two parties without going through an exchange or other intermediary.
- The contract between the two parties are privately negotiated.
- The contract can be tailor-made to the two parties' liking.
- Over-the-counter markets are uncontrolled, unregulated and have very few laws.
- Its more like a freefall.

Forward Contract

- A forward is a contract in which one party commits to buy and the other party commits to sell a specified quantity of an agreed upon asset for a pre-determined price at a specific date in the future.
- It is a customized contract, in the sense that the terms of the contract are agreed upon by the individual parties.
- Hence, it is traded OTC.

Future Swaps

- A future is a standardised forward contract.
- It is traded on an organised exchange.
- It has following standardisations i.e.

➢ Pre-defined delivery dates and procedure.

➢ price quotes.

Option Swaps

- Contracts that give the holder the option to buy/sell specified quantity of the underlying assets at a particular price on or before a specified time period.
- The word “option” means that the holder has the right but not the obligation to buy/sell underlying assets.

Types of Options

- Options are of two types – call and put.

a. Call option give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a particular date by paying a premium.
b. Put option give the buyer the right but not obligation to sell a given quantity of the underlying asset at a given price on or before a particular date by paying a premium.

Depository Receipts

- Depository receipts are instruments issued by international depositories (ODB), and they represent an interest in the underlying shares held by them in the issuer company (Indian Company).
- The shares are usually held by a domestic custodian on behalf of the depositories in turn issue the depository receipts, which entitle the holder of the receipts to get the underlying shares on demand.
- DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, London, etc.
- DRs listed and traded in US markets are known as American Depository Receipts (ADRs) and those listed and traded elsewhere are known as Global Depository Receipts (GDRs).
- In Indian context, DRs are treated as FDI.

AMERICAN DEPOSITORY RECEIPTS

- ADR is a dollar-denominated negotiable certificate.
- It represents a non-US company's publicly traded equity.
- It was devised in the late 1920s to help Americans invest in overseas securities and to assist non-US companies wishing to have their stock traded in the American Markets.
- ADR were introduced as a result of the complexities involved in buying shares in foreign countries and the difficulties associated with trading at different prices and currency values.

GLOBAL DEPOSITORY RECEIPTS

- A bank certificate issued in more than one country for shares in a foreign company.
- The shares are held by a foreign branch of an international bank.
- The shares trade as domestic shares, but are offered for sale globally through the various bank branches.
- A financial instrument used by private markets to raise capital denominated in either U.S. dollars or Euros.
- The voting rights of the shares are exercised by the Depository as per the understanding between the issuing company and the GDR holders.

INDIAN DEPOSITORY RECEIPTS

- As per the definition given in the Companies (Issue of Indian Depository Receipts) Rules, 2004, IDR is an instrument in the form of a Depository Receipt created by the Indian depository in India against the underlying equity shares of the issuing company.
- In an IDR, foreign companies would issue shares, to an Indian Depository (say National Security Depository Limited – NSDL), which would in turn issue depository receipts to investors in India.
- The actual shares underlying the IDRs would be held by an Overseas Custodian, which shall authorize the Indian Depository to issue the IDRs.

Lease Financing

- A written agreement under which a property owner allows a tenant to use the property for a specified period and time.
- The lessee(person who taking out a lease) agrees to pay number of fixed and flexible installments over an agreed period to lessor, who remains the owner of asset(product) throughout the period of the lease.
- Leasing a product is similar to renting it.
- A contract usually between 2 to 10 years depending on cost and usable life of the product or assets.
- The lessee has a full right to use the complete leased asset without having to pay full cost of the asset in one time.