LECTURE NOTES
ON
FINANCIAL INSTITUTIONS, MARKETS AND SERVICES
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Department of Management Studies
Course Name : Financial Institutions, Markets and Services (17CE00322)
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SYLLABUS

Unit – I
Overview of Financial System
Classes: 10

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Unit – v
Stock Exchange
Classes: 10
Meaning and definition, Role and function, regulatory framework of stock exchange, profile of Indian Stock exchanges, listing, trading.

References:
1. Financial Markets and services, Appannaiah, Reddy and Sharma, HPH
2. Financial services, Gorden & Natarajan, Himalaya publishers.
5. Financial Services and markets, Dr.Punithavathy Pandian, Vikas
6. Indian Financial System, Ramachandra and others, HPH
9. Financial services, Thirpati, PHI.

Mode of Evaluation: Assignments, Seminars, Written Examinations
UNIT-1
AN OVERVIEW OF INDIAN FINANCIAL SYSTEM

INDIAN FINANCIAL SYSTEM

INTRODUCTION

Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. This paper discusses the meaning of finance and Indian Financial System and focus on the financial markets, financial intermediaries and financial instruments. The brief review on various money market instruments are also covered in this study.

The term "finance" in our simple understanding it is perceived as equivalent to 'Money'. We read about Money and banking in Economics, about Monetary Theory and Practice and about "Public Finance". But finance exactly is not money; it is the source of providing funds for a particular activity. Thus public finance does not mean the money with the Government, but it refers to sources of raising revenue for the activities and functions of a Government. Here some of the definitions of the word 'finance' both as a source and as an activity i.e. as a noun and a verb.

INDIAN FINANCIAL SYSTEM

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.

There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities. Financial System;

The word "system", in the term "financial system", implies a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance-the three terms are intimately related yet are somewhat different from each other. Indian financial system consists of financial market, financial instruments and financial intermediation. These are briefly discussed below;

FINANCIAL MARKETS

A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial Assets or Financial Instruments represents a claim to the payment of a sum of money sometime in the future and /or periodic payment in the form of interest or dividend.

1. Money Market - The money market ifs a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

2. Capital Market - The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.

3. Forex Market - The Forex market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

Credit Market- Credit market is a place where banks, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.
CONSTITUENTS OF A FINANCIAL SYSTEM

FINANCIAL INTERMEDIATION

Having designed the instrument, the issuer should then ensure that these financial assets reach the ultimate investor in order to garner the requisite amount. When the borrower of funds approaches the financial market to raise funds, mere issue of securities will not suffice. Adequate information of the issue, issuer and the security should be passed on to take place. There should be a proper channel within the financial system to ensure such transfer. To serve this purpose, Financial intermediaries came into existence. Financial intermediation in the organized sector is conducted by a widerange of institutions functioning under the overall surveillance of the Reserve Bank of India. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating in the financial markets include; investment bankers, underwriters, stock exchanges, registrars, depositaries, custodians, portfolio managers, mutual funds, financial advertisers financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc. Though the markets are different, there may be a few intermediaries offering their services in move than one market e.g. underwriter. However, the services offered by them vary from one market to another.

Characteristics of a well-functioning financial system
The financial system plays a vital role in supporting sustainable economic growth and meeting the financial needs of Australians. It does this by facilitating funding, liquidity and price discovery, while also providing effective risk management, payment and some monitoring services.
The Inquiry believes the financial system achieves this most effectively when it operates in an efficient and resilient manner and treats participants fairly. This occurs when participants fulfil their roles and responsibilities in a way that engenders confidence and trust in the system.
The financial industry makes a considerable contribution to employment and economic output in Australia. However, the Inquiry believes the focus of financial system policy should be primarily on the degree of efficiency, resilience and fairness the system achieves in facilitating economic activity, rather than on its size or direct contribution (such as through wages and profits) to the economy.

EFFICIENCY

An efficient financial system is fundamental to supporting Australia’s growth and productivity. An efficient system allocates Australia’s scarce financial and other resources for the greatest possible benefit to our economy, promoting a higher and more sustainable rate of productivity, and economic growth. The Inquiry is concerned with three distinct, but interrelated, forms of efficiency:

1. Operational efficiency — where financial products and services are delivered in a way that minimises costs and maximises value. This largely depends on how effectively firms deploy labour, capital and technology, and the regulations with which firms comply. Strong competition, both from new entrants and incumbents, encourages firms to innovate and increase operational efficiency to survive and prosper. This can be seen in the ongoing industry focus on deploying new technologies in the Australian financial system to improve the quality and reduce the cost of products and services. Good policy-making can also assist operational efficiency by providing a stable regulatory environment and well-designed regulation that takes into account its likely effect on industry.

2. Allocative efficiency — where the financial system allocates financial resources to the most productive and valuable use. Central to achieving allocative efficiency is the ability of prices to adjust freely to give
participants information about the value and risk of various financial products and services. Prices help allocate financial resources to productive uses. Prices also help allocate risks to those most willing and able to bear them, such as through insurance or derivative contracts. For prices to play this role, market participants require access to comprehensive information about the risks and expected returns of financial products. Allocative efficiency can be hampered by ineffective disclosure, government guarantees (explicit or implicit) and tax policies that distort price signals.

3. **Dynamic efficiency** — where the financial system delivers price signals that induce the optimal balance between consumption and saving (deferred consumption). At times, policy intervention may be required to overcome behavioural biases that impede an economy’s ability to allocate resources with dynamic efficiency. For example, Australia’s compulsory superannuation system was introduced, in part, to overcome the tendency of individuals to underestimate the value of deferred consumption for long periods, such as for retirement.

4. **Resilience**
Resilience refers to the financial system’s capacity to adjust to both the normal business cycle and a severe economic shock. A resilient system does not preclude failure, nor necessarily imply price stability. Rather, a resilient system can adjust to changing circumstances while continuing to provide core economic functions, even during severe but plausible shocks. In a resilient system, individual institutions in distress should be resolvable with minimal costs to depositors, policy holders, taxpayers and the real economy. Occasional episodes of financial instability are inherent in a market economy and are typically associated with asset price volatility, high levels of leverage, under-pricing of risks and mismatches between assets and liabilities. History suggests that events of instability will continue to occur, but their timing, severity and causes cannot be reliably predicted.

6. **Fair treatment**
Fair treatment occurs where participants act with integrity, honesty, transparency and non-discrimination. A market economy operates more effectively where participants enter into transactions with confidence that they will be treated fairly.

**CULTURE OF FINANCIAL FIRMS**

Since the GFC, a persistent theme of international political and regulatory discourse has been the breakdown in financial firms’ behaviour in failing to balance risk and reward appropriately and in treating their customers unfairly. Without a culture supporting appropriate risk-taking and the fair treatment of consumers, financial firms will continue to fall short of community expectations. This may lead to ongoing political pressure for additional financial system regulation and the undermining of confidence and trust in the financial system.

An organisation’s culture reflects its accumulated knowledge, beliefs and values in a way that sets norms for the behaviour of its employees and their decision making. Organisational objectives, business strategies and systems all influence employees’ behaviour, which reflects on an organisation’s culture. Leaders and their governing bodies determine organisational culture through their own conduct and design of objectives, strategies and systems. This creates competitive advantage.

The Inquiry considers that industry should raise awareness of the consequences of its culture and professional standards, recognising that, responsibility for culture in the financial system ultimately rests with individual firms and the industry as a whole. Culture is a set of beliefs and values that should not be prescribed in legislation. To expect regulators to create the ‘right’ culture within firms by using prescriptive rules is likely to lead to over-regulation, unnecessary compliance cost and a lessoning of competition. The responsibility for setting organisational culture rightly rests with its leadership.

Components of Indian Financial System

The financial system of an economy provides the way to collect money from the people who have it and distribute it to those who can use it best. So, the efficient allocation of economic resources is achieved by a financial system that distributes money to those people and for those purposes that will yield the best returns.
The financial system is composed of the products and services provided by financial institutions, which includes banks, insurance companies, pension funds, organized exchanges, and the many other companies that serve to facilitate economic transactions. Virtually all economic transactions are effected by one or more of these financial institutions. They create financial instruments, such as stocks and bonds, pay interest on deposits, lend money to creditworthy borrowers, and create and maintain the payment systems of modern economies.

These financial products and services are based on the following fundamental objectives of any modern financial system:
I. To provide a payment system
II. To give time value to money
III. To offer products and services to reduce financial risk or to compensate risk-taking for desirable objectives
IV. To collect and disperse information that allows the most efficient allocation of economic resources
V. To create and maintain financial markets that provide prices, which indicates how well investments are performing, determines the subsequent allocation of resources, and to maintain economic stability in the markets

COMPONENTS OF FINANCIAL SYSTEM
A financial system refers to a system which enables the transfer of money between investors and borrowers. A financial system could be defined at an international, regional or organizational level. The term “system” in “Financial System” indicates a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within an economy. There are five components of Financial System which is discussed below:

1. Financial Institutions: It ensures smooth working of the financial system by making investors and borrowers meet. They mobilize the savings of investors either directly or indirectly via financial markets by making use of different financial instruments as well as in the process using the services of numerous financial services providers. They could be categorized into Regulatory, Intermediaries, Non-intermediaries and Others. They offer services to organizations looking for advises on different problems including restructuring to diversification strategies. They offer complete series of services to the organizations who want to raise funds from the markets and take care of financial assets, for example deposits, securities, loans, etc.

2. Financial Markets: A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial Assets or Financial Instruments represent a claim to the payment of a sum of money sometime in the future and /or periodic payment in the form of interest or dividend. There are four components of financial market are given below:
   I. Money Market: The money market is a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.
   II. Capital Market: The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.
   III. Foreign Exchange Market: The Foreign Exchange market deals with the multicurrency requirements which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated markets across the globe.
   IV. Credit Market: Credit market is a place where banks, Financial Institutions (FIs) and Non Bank Financial Institutions (NBFCs) purvey short, medium and long-term loans to corporate and individuals.

3. Financial Instruments: This is an important component of financial system. The products which are traded in a financial market are financial assets, securities or other types of financial instruments. There are a wide range of securities in the markets since the needs of investors and credit seekers are different. They
indicate a claim on the settlement of principal down the road or payment of a regular amount by means of interest or dividend. Equity shares, debentures, bonds, etc. are some examples.

4. **Financial Services:** It consists of services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested. They assist to determine the financing combination and extend their professional services up to the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. These range from the leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses. The financial services sector offers a number of professional services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. Financial institutions and financial markets help in the working of the financial system by means of financial instruments. To be able to carry out the jobs given, they need several services of financial nature. Therefore, financial services are considered as the 4th major component of the financial system.

5. **Money:** It is understood to be anything that is accepted for payment of products and services or for the repayment of debt. It is a medium of exchange and acts as a store of value. It eases the exchange of different goods and services for money.

### SAVINGS-INVESTMENT RELATIONSHIP

The above three major functions are important for the running and development activities of any economy. Apart from these functions, an economy’s growth is boosted by the savings-investment relationship. When there are sufficient savings, only then can there be sizeable investment and production activity. This savings facility is provided by financial institutions through attractive interest schemes. The money saved by the public is used by the financial institutions for lending to businesses at substantial interest rates. These funds allow businesses to increase their production and distribution activities.

#### Growth of capital markets

Another important work of finance is to boost growth of capital markets. Businesses need two types of capital – fixed and working. Fixed capital refers to the money needed to invest in infrastructure such as building, plant and machinery. Working capital refers to the money needed to run the business on a day-to-day basis. This may refer to the ongoing purchase of raw materials, cost of finishing goods and transport of finished goods to stores or customers. The financial system helps in raising capital in the following ways:

- **Fixed capital** – Businesses issue shares and debentures to raise fixed capital. Financial service providers, both public and private, invest in these shares and debentures to make profits with minimal risk.
- **Working capital** – Businesses issue bills, promissory notes etc. to raise short term loans. These credit instruments are valid in the money markets that exist for this purpose.

#### Foreign exchange markets

In order to support the export and import businessmen, there are foreign exchange markets whereby businesses can receive and transmit funds to other countries and in other currencies. These foreign exchange markets also enable banks and other financial institutions to borrow or lend sums in other currencies. Moreover, financial institutions can invest and reap profits from their short term idle money by investing in foreign exchange markets. Governments also meet their foreign exchange requirements through these markets. Hence, foreign exchange markets impact the growth and goodwill of an economy in the international markets.

#### Government securities

Governments use the financial system to raise funds for both short term and long term fund requirements. Governments issue bonds and bills at attractive interest rates and also provide tax
concessions. Budget gaps are taken care of by government securities. Thus, capital markets, foreign exchange markets and government securities markets are essential for helping businesses, industries and governments to carry out development and growth activities of the economy.

**Infrastructure and growth**

The economic growth depends on the growth of infrastructural facilities of the country. Key industries such as power, coal, oil determine the growth of other industries. These infrastructure industries are funded by the finance system of the country. The capital requirement for infrastructure industries is huge. Raising such a huge amount is difficult for private players and hence, traditionally, governments have taken care of infrastructure projects solely. However, the economic liberalization policy led to the private sector participation in infrastructure industries. Development and Merchant banks such as IDBI in India help fund these activities for the private sector.

**Trade development**

Trade is the most important economic activity. Both, domestic and international trade are supported by the financial system. Traders need finance which is provided by the financial institutions. Financial markets on the other hand help discount financial instruments such as promissory notes and bills. Commercial banks finance international trade through pre and post-shipment funding. Letters of credit are issued for importers, thereby helping the country to earn important foreign exchange.

**Employment growth**

Financial system plays a key role in employment growth in an economy. Businesses and industries are financed by the financial systems which lead to growth in employment and in turn increases economic activity and domestic trade. Increase in trade leads to increase in competition which leads to activities such as sales and marketing which further increases employment in these sectors.

**Venture capital**

Increase in venture capital or investment in ventures will boost growth in economy. Currently, the extent of venture capital in India is less. It is difficult for individual companies to invest in ventures directly due to the risk involved. It is mostly the financial institutions that fund ventures. An increase in the number of financial institutions supporting ventures will boost this segment.

**Balances economic growth**

The growth of different sectors of an economy is balanced through the financial system. There are primary, secondary and tertiary sector industries and all need sufficient funds for growth. The financial system of the country funds these sectors and provides sufficient funds for each sector – industrial, agricultural and services.

**UNDERSTANDING FINANCIAL REGULATORY BODIES IN INDIA**

In India, the financial system is regulated with the help of independent regulators, associated with the field of insurance, banking, commodity market, and capital market and also the field of pension funds. On the other hand, the Indian Government is also known for playing a significant role in controlling the field of financial security and also influencing the roles of such mentioned regulators. You must be aware of the regulatory bodies and their functions, before a final say. The most prominent of all is RBI or Reserve Bank of India. Let us look in detail about various Financial Regulatory Bodies in India.

**RBI – Reserve Banks of India :**

Reserve Bank of India : Reserve Bank of India is the apex monetary Institution of India. It is also called as the central bank of the country.
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 nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

The Central Office is where the Governor sits and is where policies are formulated. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

**SEBI – Securities and Exchange Board of India:**

SEBI logo Apart from RBI, SEBI also forms a major part under the financial body of India. This is a regulator associated with the security markets in Indian Territory. Established in the year 1988, the SEBI Act came into power in the year 1992, 12th April. The board comprises of a Chairman, Whole time members, Joint secretary, member appointed, Deputy Governor of RBI, secretary of corporate affair ministry and also part time member. There are three groups, which fall under this category, and those are the investors, the security issuers and market intermediaries.

**PFRDA – Pension Fund Regulatory and Development Authority:**

PFRDA Logo Pension Fund regulatory is a pension related authority, which was established in the year 2003 by the Indian Government. It is authorized by the Finance Ministry, and it helps in promoting income security of old age by regulating and also developing pension funds. On the other hand, this group can also help in protecting the interest rate of the subscribers, associated with the schemes of pension money along with the related matters. PFRDA is also responsible for the appointment of different other intermediate agencies like Pension fund managers, CRA, NPS Trustee Bank and more.

**FMC – Forward Markets Commission:** FMC logo Other than the financial bodies mentioned above, FMC also plays a major role. It is the chief regulator of the commodity (MCX, NCDEX, NMCE, UCX etc) of the Indian futures market. As per the latest news feed, it has regulated the amount of Rs. 17 trillion, under the commodity trades. Headquarter is located in Mumbai, and the financial regulatory agency is working in collaboration with the Finance Ministry. The chairman of FMC works together with the Members of the same organization to meet the required ends. The main aim of this body is to advise the Central Government on matters of the Forwards Contracts Act, 1952.

**IRDA – Insurance Regulatory and Development Authority:**

IRDA Logo Lastly, it is better to mention the name of IRDA or insurance regulatory and Development authority, as a major part of the financial body. This company is going to regulate the apex statutory body, which will regulate and at the same time, develop the insurance industry. It comprised of the Indian Parliamentary act and was passed duly by the Indian Government. Headquarter of this group is in Hyderabad, and it was shifted from Delhi to Hyderabad. These are some of the best-possible points, which you can try and focus at, while dealing with financial bodies of India.

Reserve Bank of India (RBI) is the central bank of the country. The Reserve Bank was established in 1935 by the Banking Regulation Act, 1934 with a capital of Rs. 5 cr. Initially the ownership of almost all the shares capital was in the hands of non-government share holders. So in order to prevent the centralisation of the shares in few hands, the RBI was nationalised on January 1, 1949.

**Functions of Reserve Bank**

1. **Issue of Notes** — The Reserve Bank has the monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations except one rupee note (which is issued by the Ministry of Finance). The Reserve Bank has adopted the Minimum Reserve System for issuing/printing the currency notes. Since 1957, it maintains gold and foreign exchange reserves of Rs. 200 Cr. of which at least Rs. 115 cr. should be in gold and remaining in the foreign currencies.

2. **Banker to the Government** – The second important function of the Reserve Bank is to act as the Banker, Agent and Adviser to the Government of India and states. It performs all the banking functions of the State.
and Central Government and it also tenders useful advice to the government on matters related to economic and monetary policy. It also manages the public debt of the government.

3. Banker’s Bank: The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.

Structure of Banking Sector in India

4. Controller of the Credit: The RBI undertakes the responsibility of controlling credit created by the commercial banks. RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country. When RBI observes that the economy has sufficient money supply and it may cause inflationary situation in the country then it squeezes the money supply through its tight monetary policy and vice versa.

Where do Printing of Security Papers, Notes and Minting take Place in India?

5. Custodian of Foreign Reserves: For the purpose of keeping the foreign exchange rates stable, the Reserve Bank buys and sells the foreign currencies and also protects the country’s foreign exchange funds. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa. Currently India has Foreign Exchange Reserve of around US$ 360bn.

6. Other Functions: The Reserve Bank performs a number of other developmental works. These works include the function of clearing house arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities (gilt edge, treasury bills etc)and trade bills, giving loans to the Government buying and selling of valuable commodities etc. It also acts as the representative of Government in International Monetary Fund (I.M.F.) and represents the membership of India.

New department constituted in RBI: On July 6, 2005 a new department, named financial market department in reserve bank of India was constituted for surveillance on financial markets. This newly constituted dept. will separate the activities of debt management and monetary operations in future. This department will also perform the duties of developing and monitoring the instruments of the money market and also monitoring the government securities and foreign money markets. So it can be concluded that as soon as the our country is growing the role of RBI is going to be very crucial in the upcoming years.

Roles & Functions of Reserve Bank of India – Introduction

India is one of the fastest growing economies in the world, with a population over 1.2 Billion, has become the hub for global investment. There are various factors that influence and control Indian economy, one such being, The RBI, one of the oldest institution behind the success of our economy.

The RBI is the backbone of Indian economy and because of it, growth in Exports, FOREX, Capital Markets and other sectors of the economy are all happening. It plays an important role in strengthening, developing and diversifying the country’s economic and financial structure. It is the apex bank in the Indian Banking System.

The Reserve Bank of India (RBI) is India’s Central banking institution, which controls the monetary policy of the Indian rupee. The Reserve Bank of India was established on April 1, 1935, in accordance with the provisions of the Reserve Bank of India Act, 1934. Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India. The Preamble of the Reserve Bank of India describes the basic Functions of Reserve Bank of India as: “to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability
while keeping in mind the objective of growth.”

**FUNCTIONS OF SEBI**

1. Protective Functions:
As the name suggests, the main focus of this function of SEBI is to protect the interest of investor and security of their investment

As protective functions SEBI performs following functions:

(i) SEBI checks Price Rigging:
Price Rigging means some people manipulate the prices of securities for inflation or depressing the market price of securities. SEBI prohibits such practice to avoid fraud and cheating which can happen to any investor.

(ii) SEBI prohibits Insider trading:
Any person which is connected with a company such as directors, promoters, workers etc is called Insiders. Due to working in the company they have sensitive information which affects the prices of the securities. Such information is not available to people at large but Insider gets this key full knowledge by working in such company. Insider can use this information for their personal benefits or make a profit from it, such process is known as Insider Trading.

For Example - Managers or Directors of a company may know that company will issue Bonus shares to its shareholders at a particular time and they purchase shares from market to make a profit with bonus issue.

SEBI always restricts these types of practices when Insiders are buying securities of the company and take strict action to avoid this in future.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:
SEBI always restricts the companies which make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI sometimes educate the investors so that become able to evaluate the securities and always invest in profitable securities.

(v) SEBI issues guidelines to protect the interest of debenture holders.

(vi) SEBI is empowered to investigate cases of insider trading and has provision for stiff fine and imprisonment.

(vii) SEBI has stopped the practice of allotment of preferential shares unrelated to market prices.

(vii) SEBI has stopped the practice of making a preferential allotment of shares unrelated to market prices.

2. Developmental Functions:
Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting a flexible and adaptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.
(c) An initial public offer of primary market is permitted through the stock exchange.

3. Regulatory Functions:
These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

Other Functions
1. Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to issue, trustees of the trust deed, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment adviser and such other intermediaries who may be associated with securities markets in any manner.

2. SEBI also perform the function of registering and regulating the working of depositories, custodians of securities. Foreign Institutional Investors, credit rating agencies etc.

3. Registering and regulating the working of Venture Capital Funds and collective investments schemes including mutual funds.

4. Promoting and regulating self - regulatory organizations.

5. Calling for information form, undertaking inspection, conducting inquiries and audits of the stock exchange, mutual funds and intermediaries and self - regulatory organizations in the securities market.

6. Calling for information and record from any bank or any other authority or boards or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which are under investigation or inquiry by the Board.

7. Conduct research on any matter described if any.

8. Calling information from any agency, institution, banks etc.
FINANCIAL INSTITUTIONS:

- Finance Corporation of India (IFCI)
- Industrial Credit and Investment Corporation of India (ICICI)
- State Financial Corporation’s (SFCs)
- State Industrial Development Corporations (SIDC’S)
- Industrial Development Bank of India (IDBI)
- Industrial Investment Bank of India (IIBIL)
- Unit Trust of India (UTI)
- Small Industries Development Bank of India (SIDBI)
- Financial Institution # 1. Industrial Finance Corporation of India (IFCI):

The Industrial Finance Corporation of India was established in 1948 under the IFC Act, 1948. The main objective of the corporation has been to provide medium and long-term credit to industrial concerns in India. The financial assistance of the corporation is available to limited companies or co-operative societies registered in India and engaged or proposing to engage in:

(a) Manufacture, preservation or processing of goods

(b) The mining industry;

(c) The shipping business;

(d) The hotel industry; and

(e) The generation or distribution of electricity or any other form of power.

Initially the authorised capital of the corporation was Rs. 10 crore which was divided in equities of Rs. 5,000 each. Later on the authorised capital was increased to Rs. 20 crore. Since July 1, 1993 this corporation has been converted into a company and it has been given the status of a limited company with the name Industrial Finance Corporation of India Ltd. IFCI has got its registration under Companies Act, 1956.

Before July 1, 1993, general public was not permitted to hold shares of IFCI. Only Government of India, RBI, Scheduled Banks, Insurance Companies and Co-operative Societies were holding the shares of IFCI. The financial resources of IFCI consist of paid-up capital, reserves, repayment of loans, market borrowings in the form of bonds/debentures, loans from Government of India, advances from the Industrial Development Bank of India and foreign currency loans.

Banking and Financial Institutions

There is lot more to banking term than what most of the people recognize. Not all banks are shaped in equal manner or to operate for the same reason with same fundamentals. Since individuals or corporate have diversified needs of finance. “Different types of banking and financial institutions are operated to classify services based on distinctive types”. Name banks subject to large entity they are further divided into types based on universal arrangement of capital principles. Bank is an financial institution or intermediary institution for various financial necessities and dealing either directly or indirectly with financial system of nation’s economy. Due to this important factors banks are highly regulated by nation’s government or central bank of country. Banking industry is divided into different types based on client requirements for products and services.

Types of Banking Institutions and Financial Institutions:
Retail Banking.
- Commercial Banking.
- Private Banking.
- Investment Banking.
- Specialized financing.
- Central Banks.

Retail Banking: Retail banking is the procurement of administrations by a bank to individual rather than to organizations, corporate or other banks. Administrations offered services like savings, money transfers, loans, cheques, cards, etc. The term retail banking mostly recognize as financial institutions for managing an account administrations for individuals or managing retail clients which distinguish it from other banking types. To further understand retail banking refer to tutorial links.

Commercial Banking: Commercial banks provide administrations services such as making business advances, offering fundamental investment schemes, encouraging saving deposits, fixed deposits, Issuing bank drafts and bank cheques, giving overdraft facilities, bond investment schemes, cash management, mortgage loans, debit cards, credit cards, etc. There are two types of commercial banks, Public Commercial Banks and Private Commercial Banks.

Private Banking: The expression “private” refers to administration services more on personal basis rather than mass population (Retail Banking). Private Banks refer as financial institutions for managing accounts, investments and other services offered by banks to high-net worth individuals (HNI) who are categories as high income professionals or large investors. Private banks subject to an essential part of wealth management for high income groups. They provide services like: assets management, tax advisory, financial brokers, offered solitary relationship manger. To understand Private Banks in more elaborated way, refer to the tutorial course links.

Investment Banking: An investment bank refers as a consultant or assisting institution for individuals, organisations and governments in raising capital by underwriting assets. And/or performing broker in issuing securities. An investment bank likewise assist organisations in simplifying acquisitions and mergers, trading in derivatives, equities, currencies, commodities by providing auxiliary services. Investment bank does not provide deposit services like commercial banks or retail banks. Investment bank can likewise be divided into private and public based on information capacities and data obstruction. The private ranges deals with private insider data that cannot be freely disclosed, while public range such as

Central Banks: A reserve bank, central bank, or monetary authority refers to a financial institution that manages a states or country. In term of currency, interest rates, currency valuation. Central bank holds monopoly in increasing monetary base also by prints the national currency. Central bank functions mostly include managing foreign exchange and gold reserves, implementing monetary policy, acting as a banker’s bank at time of crisis, making official policies regarding interest rates. Central bank holds superior power to protect country man by punishing banks or institutions for performing any reckless or fraudulent behaviour. Central banks are mostly designed and recognised as an independent and politically free entity. Examples: Reserve Bank of India (RBI) is the central bank of India, Bank of England, European Central Bank (ECB), People’s Bank of China, Federal Reserve of the United States of America, etc

3. Operations of Commercial Banks
Commercial banks form a prominent part of the country’s Financial Institution System. Commercial Banks are those profit making institutions which accept deposits from general public and gives money (loan) to individuals like household, entrepreneurs, businessmen etc. The prime objective of these banks is to earn profit in the form of interest, commission etc. The operations of all these commercial banks are regulated by the Reserve Bank of India, which is the central bank and supreme financial authority in India.
The main source of income of a commercial bank is the difference between these two rates which they charge to borrowers and pay to depositors. Some commercial banks in India are – ICICI Bank, State Bank of India, Axis Bank, and HDFC Bank, Punjab national bank, Central bank of India.

At present, there are 27 Public Sector Banks in India including SBI (plus its 5 associates) and 19 nationalized banks. Further, there are two banks which have been categorized by RBI as “Other Public Sector Banks” i.e. IDBI and Bhartiya Mahila Bank come under this category.

Classification of commercial banks
1. Scheduled Banks: - Banks which have been included in the Second Schedule of RBI Act 1934. They are categorized as follows:
2. Public Sector Banks: - These are those banks in which majority of stake is held by the government. Eg. SBI, PNB, Syndicate Bank, Union Bank of India etc.
3. Private Sector Banks: - These are those banks in which majority of stake is held by private individuals. i.e. ICICI Bank, IDBI Bank, HDFC Bank, AXIS Bank etc.
4. Foreign Banks: - These are the banks with Head office outside the country in which they are located. Eg. Citi Bank, Standard Chartered Bank, Bank of Tokyo Ltd. etc.
5. Non scheduled commercial Banks: - Those banks which are not added in the Second Schedule of RBI Act 1934.

Functions of Commercial Banks
Primary Functions of Commercial Banks:
Deposit Acceptance:
Being a short term credit dealer, the commercial banks accept the savings of public in the form of following deposits:
1. Fixed Term deposits
2. Current A/c deposits
3. Recurring deposits
4. Saving A/c deposits
5. Tax saving deposits
6. Deposits for NRIs

Lending Money: A second major function is to give loans and advances and thereby earn interest on it. This function is the main source of income of the banks.
Overdraft facility: its permission to a current A/c holder of withdrawal more than to what he has deposited in his/her account.

Loans & Advances: A kind of secured and unsecured loans against some kind of security. Discounting of bill of exchange: in case a person wants money immediately, he/she can present the B/E to the respective commercial bank and can get it discounted.

Cash Credit:
It is a facility to withdraw a certain amount of money on a given security.

Secondary Functions of Commercial Banks:
Agency functions: Bank pays on the behalf of its customers as an agent and gets fee for agency functions such as:
1. Payment of taxes, bills
2. Collection of funds through bills, Cheques etc.
3. Transfer of funds
4. Sale-purchase of shares and debentures
5. Collection/Payment of dividend or interest
6. Acts as trustee & executor of properties
7. Foreign exchange Transactions
8. General Utility Services: locker facility

Credit Creation: It is one of the most important functions of commercial banks. A bank creates credit on the basis of its primary deposits. It further lends the money to common borrowers/ corporate/investors. This landed money is deposited by those people to have excess money and want to earn a fix return on
their money. Commercial banks charges more rate of interests from customers (borrowers) as compared to
given to the depositors of the money.
List of Commercial Banks in India

SBI & Associates:
1. State Bank of Bikaner & Jaipur
2. State Bank of Hyderabad
3. State Bank of Mysore
4. State Bank of Patiala
5. State Bank of Travancore

Nationalized Banks:
1. Allahabad Bank
2. Andhra Bank
3. Bank of Baroda
4. Bank of India
5. Bank of Maharashtra
6. Canara Bank
7. Central Bank of India
8. Corporation Bank
9. Dena Bank
10. Indian Bank
11. Indian Overseas Bank
12. Oriental Bank of Commerce
13. Punjab & Sind Bank
14. Punjab National Bank
15. Syndicate Bank
16. UCO Bank
17. Union Bank of India
18. United Bank of India
19. Vijaya Bank

Foreign Banks:
1. ABN Amro Bank
2. Abu Dhabi Commercial Bank
3. American Express Banking Corporation
4. AB Bank
5. Bank International Indonesia
6. Bank of America
7. Bank of Bahrain & Kuwait
8. Bank of Ceylon
9. Barclays Bank
10. BNP Paribas
11. Chinatrust Commercial Bank
12. Citibank
13. DBS Bank
14. Deutsche Bank
15. Hongkong & Shanghai Banking Corporation
16. JP Morgan Chase Bank
17. Standard Chartered Bank
18. UBS AG

Other Public Sector Banks:
1. IDBI Bank
2. Bhartiya Mahila Bank
Here it can be conclude that network of commercial banks will play a prominent role in the economic development coming years, especially after the introduction of plan of financial inclusion in the whole country.

**PRIMARY FUNCTIONS OF BANKS**

1. **Accepting Deposits**

The bank collects deposits from the public. These deposits can be of different types, such as :-

   Saving Deposits  
   Fixed Deposits  
   Current Deposits  
   Recurring Deposits  

   a. Saving Deposits

   This type of deposits encourages saving habit among the public. The rate of interest is low. At present it is about 4% p.a. Withdrawals of deposits are allowed subject to certain restrictions. This account is suitable to salary and wage earners. This account can be opened in single name or in joint names.

   b. Fixed Deposits

   Lump sum amount is deposited at one time for a specific period. Higher rate of interest is paid, which varies with the period of deposit. Withdrawals are not allowed before the expiry of the period. Those who have surplus funds go for fixed deposit.

   c. Current Deposits

   This type of account is operated by businessmen. Withdrawals are freely allowed. No interest is paid. In fact, there are service charges. The account holders can get the benefit of overdraft facility.

   d. Recurring Deposits

   This type of account is operated by salaried persons and petty traders. A certain sum of money is periodically deposited into the bank. Withdrawals are permitted only after the expiry of certain period. A higher rate of interest is paid.

2. **Granting of Loans and Advances**

The bank advances loans to the business community and other members of the public. The rate charged is higher than what it pays on deposits. The difference in the interest rates (lending rate and the deposit rate) is its profit.

**The types of bank loans and advances are :-**

   - Overdraft
- Cash Credits
- Loans
- Discounting of Bill of Exchange

**a. Overdraft**

This type of advances are given to current account holders. No separate account is maintained. All entries are made in the current account. A certain amount is sanctioned as overdraft which can be withdrawn within a certain period of time say three months or so. Interest is charged on actual amount withdrawn. An overdraft facility is granted against a collateral security. It is sanctioned to businessman and firms.

**b. Cash Credits**

The client is allowed cash credit up to a specific limit fixed in advance. It can be given to current account holders as well as to others who do not have an account with bank. Separate cash credit account is maintained. Interest is charged on the amount withdrawn in excess of limit. The cash credit is given against the security of tangible assets and / or guarantees. The advance is given for a longer period and a larger amount of loan is sanctioned than that of overdraft.

**c. Loans**

It is normally for short term say a period of one year or medium term say a period of five years. Now-a-days, banks do lend money for long term. Repayment of money can be in the form of installments spread over a period of time or in a lumpsum amount. Interest is charged on the actual amount sanctioned, whether withdrawn or not. The rate of interest may be slightly lower than what is charged on overdrafts and cash credits. Loans are normally secured against tangible assets of the company.

**d. Discounting of Bill of Exchange**

The bank can advance money by discounting or by purchasing bills of exchange both domestic and foreign bills. The bank pays the bill amount to the drawer or the beneficiary of the bill by deducting usual discount charges. On maturity, the bill is presented to the drawee or acceptor of the bill and the amount is collected.

**1. Agency Functions**

The bank acts as an agent of its customers. The bank performs a number of agency functions which includes :-

- Transfer of Funds
- Collection of Cheques
- Periodic Payments
- Portfolio Management
- Periodic Collections
- Other Agency Functions

**a. Transfer of Funds**

The bank transfer funds from one branch to another or from one place to another.
b. Collection of Cheques

The bank collects the money of the cheques through clearing section of its customers. The bank also collects money of the bills of exchange.

c. Periodic Payments

On standing instructions of the client, the bank makes periodic payments in respect of electricity bills, rent, etc.

d. Portfolio Management

The banks also undertakes to purchase and sell the shares and debentures on behalf of the clients and accordingly debits or credits the account. This facility is called portfolio management.

e. Periodic Collections

The bank collects salary, pension, dividend and such other periodic collections on behalf of the client.

f. Other Agency Functions

They act as trustees, executing, advisers and administrators on behalf of its clients. They act as representatives of clients to deal with other banks and institutions.

2. General Utility Functions

The bank also performs general utility functions, such as :-

- Issue of Drafts, Letter of Credits, etc.
- Locker Facility
- Underwriting of Shares
- Dealing in Foreign Exchange
- Project Reports
- Social Welfare Programmes
- Other Utility Functions

a. Issue of Drafts and Letter of Credits

Banks issue drafts for transferring money from one place to another. It also issues letter of credit, especially in case of, import trade. It also issues travellers' cheques.

b. Locker Facility
The bank provides a locker facility for the safe custody of valuable documents, gold ornaments and other valuables.

c. Underwriting of Shares

The bank underwrites shares and debentures through its merchant banking division.

d. Dealing in Foreign Exchange

The commercial banks are allowed by RBI to deal in foreign exchange.

e. Project Reports

The bank may also undertake to prepare project reports on behalf of its clients.

f. Social Welfare Programmes

It undertakes social welfare programmes, such as adult literacy programmes, public welfare campaigns, etc.

g. Other Utility Functions

It acts as a referee to financial standing of customers. It collects creditworthiness information about clients of its customers. It provides market information to its customers, etc. It provides travellers' cheque facility

BANKING IN INDIA: DEFINITION, FUNCTIONS AND TYPES OF BANKS

Definition of a Bank

A bank is a financial institution which performs the deposit and lending function. A bank allows a person with excess money (Saver) to deposit his money in the bank and earns an interest rate. Similarly, the bank lends to a person who needs money (investor/borrower) at an interest rate. Thus, the banks act as an intermediary between the saver and the borrower. The bank usually takes a deposit from the public at a much lower rate called deposit rate and lends the money to the borrower at a higher interest rate called lending rate. The difference between the deposit and lending rate is called ‘net interest spread’, and the interest spread constitutes the banks income.

Essential Features/functions of the Bank

Financial Intermediation

The process of taking funds from the depositor and then lending them out to a borrower is known as Financial Intermediation. Through the process of Financial Intermediation, banks transform assets into liabilities. Thus, promoting economic growth by channelling funds from those who have surplus money to those who do not have desired money to carry out productive investment.
The bank also acts as a risk mitigator by allowing savers to deposit their money safely (reducing the risk of theft, robbery) and also earns interest on the same deposit. Bank provides services like saving account deposits and demand deposits which allow savers to withdraw money on an immediate basis thus, providing liquidity (which is as good as holding cash) with security.

How Banks promote economic growth?

**TYPES/STRUCTURE OF BANKS IN INDIA**

**Scheduled Commercial Banks**
- All the commercial banks in India- Scheduled and Non-Scheduled is regulated under Banking Regulation Act 1949.
- By definition, any bank which is listed in the 2nd schedule of the Reserve Bank of India Act, 1934 is considered a scheduled bank. The list includes the State Bank of India and its subsidiaries (like State Bank of Travancore), all nationalised banks (Bank of Baroda, Bank of India etc), Private sector banks, Foreign banks, regional rural banks (RRBs), foreign banks (HSBC Holdings Plc, Citibank NA) and some co-operative banks.
- Till 2017, Scheduled commercial banks in India comprised 26 Public sector banks including SBI and its associates, and 19 Nationalised Bank and IDBI. The creation of Bhartiya Mahaila Bank has increased the total no of Public sector SCB’s to 27, but the recent merger of the Mahaila Bank with SBI had reduced the list back to 26.
- The scheduled private sector bank includes old private sector banks and new private sector banks. There are 13 old private sector banks and 9 new private sector banks including the newly formed IDFC and Bandhan Bank.
- There are also 43 Foreign National Banks operating in India.
- The Regional Rural Banks were started in India back in the 1970s due to the inability of the commercial banks to lend to farmers/rural sectors/agriculture. The governance structure/shareholding of RRBs is as follows:
  - Central Government: 50%, State Government: 15% and Sponsor Bank: 35%.
  - RBI has kept CRR (Cash Reserve Requirements) of RRBs at 3% and SLR (Statutory Liquidity Requirement) at 25% of their total net liabilities.

**Important Facts Relating to Scheduled Commercial Banks**
- In terms of Business, Public sector banks dominate the Indian Banking.
- PSB accounts for close to 50% of total assets, 70% of deposits and close to 70% of the advances.
- Amongst the Public-Sector Banks, SBI and its Associates has the highest number of Branches.
- The committee on Regional Rural Bank headed by M Narasimhan recommended the setting up of RRBs for the purpose of providing rural credit.
- An RRB is sponsored by a Public-Sector Bank which also provides a part of its share capital. Example: Maharashtra Gramin Bank (sponsored by the Bank of Maharashtra) and the Himachal Gramin Bank (Sponsored by Punjab National Bank). RRBs were set up to eliminate other unorganized financial institutions like money lenders and supplement the efforts of co-operative banks.
- The Private Commercial banks account for close to 1/4th of the assets of the total banking assets.

Why RRBs Failed to Achieve ITs Objective

**Meaning of Banks:**
A bank (German word) means a joint stock fund. A bank denotes a financial institution dealing in money. A bank is an institution that is prepared to accept deposits of money and repay the same on demand. The system of banking is very old and the same was prevalent in Greece, India and Rome.

A banker (i.e., person or a corporation) deals in credit and money i.e. it accepts deposits from those who want to commit their wealth to safety and earn interest thereon, and lends money to the needy through cheques and advances and loans of various sorts.
Functions of a Bank:
A bank performs the following functions:

(a) It accepts deposits from the customers, who can take back their money at will. A saving bank also pays interest to customers on their deposits and is popular with small savers.

Customers can leave their cash with the bank as Saving Account, Current Account or a Fixed Deposit Account.

Customers deposit their money in Saving Bank Account to save a part of their current incomes to meet their future needs and also intend to earn an income from their savings (bank interest). For the depositor, the number of withdrawals over a period of time and the total amount of one or more withdrawals on any date, are however limited.

A Current Account on the other hand is running account which may be operated upon any number of times during a working day. There is no restriction on the number and amount of withdrawals. The bank does not pay any interest; rather it takes incidental charges from the depositor on such accounts in some cases.

In a Fixed Deposit Account, the deposits are made for a fixed period (say 36 months) and a higher rate of interest is paid to the depositor.

(b) A bank lends money to needy people at a certain interest rate. Banks give loan to agriculturists, industrialists and businessman who invest it in their ventures to their own profit and to the economic advancement of the country.

(c) A bank issues notes and creates other inexpensive media of exchange—a note or a cheque. The issue of notes is entrusted to the Reserve Bank of the country.

Credit instruments such as a bank note, bank drafts, cheques and letters of credit are created by Banks. These things economise the use of metallic money and make the transmission of money over long distances cheap and convenient.

(d) The deposits may be created by the bank itself by giving loans to its customers, in which case the borrower is credited with a deposit account with draw able when needed. The money borrowed from the bank is usually deposited in the same bank by the borrowers either because the bank insists on it or because of the advantages of current account deposit. Such deposits are known as Credit Deposits.

(e) Other functions of a bank are:

(i) The collection of cheques drawn on other banks.

(ii) The acceptance and collection of bills of exchange.

(iii) Dealing in foreign exchange to assist the settlement of overseas debts.

(iv) Stock Exchange trustee and executor business.

(v) Safe deposit facilities.
(vi) Making standing order payments.

(vii) Supplying change and assisting the central bank/Reserve bank in keeping the note issue in good condition.

**Types of Banks:**
The Indian Banking System consists of:

(a) The indigenous Banking System.

(b) The Modern Banking System:

(i) Commercial Banks.

(ii) State Bank of India.

(iii) Exchange Banks.

(iv) Central Bank.

(v) The Reserve Bank of India.

(a) **The Indigenous Banking System:**
The indigenous bankers are usually a family concern.

Their main functions are:

a. To advance loans against ornaments, land etc.

b. To deal in Hundies.

c. To receive deposits.

(b) The Modern Banking System:

(i) **Commercial Banks:**

Most of the banks in India are Commercial banks, e.g., Punjab National Bank, Allahabad Bank, United Commercial Bank etc. Such banks deal in short-term credit. They collect the surplus balances of the individuals and finance the temporary needs of commercial transactions. A commercial bank borrows money from individuals by accepting deposits on current account saving account, fixed deposits and miscellaneous deposits and then it lends money to Industrialists and Traders.

**As a principle, the commercial bank:**

(a) Supplies circulation capital rather than fixed capital,

(b) Gives loans for short period only,

(c) Does not involve itself too much with one industry only, because if that industry fails, the bank’s assets may become frozen.
(ii) The State Bank of India:

The Imperial Bank of India established on January 27, 1921 was renamed as the State Bank of India on July 1, 1955 after passing of the State Bank of India Act, 1955. The State Bank of India has its central office in Bombay and seven local head offices in Calcutta, Madras, Bombay, Delhi, Hyderabad, Kanpur and Ahmedabad.

The main functions of the State Bank of India are:

(i) The bank borrows money from public by accepting deposits.

(ii) It lends money to industrialists, farmers and Traders for short periods.

(iii) It provides financial assistance to importers and exporters.

(iv) It undertakes foreign exchange business.

(v) It collects cheques, drafts, bill of exchange, dividends, interest, salaries and pension on behalf of customers.

(vi) It maintains safe deposit vaults.

(iii) Exchange Banks:

Whereas commercial banks finance the internal trade of the country, the Exchange banks finance its foreign trade. Exchange banks of our country will have their head office located outside India.

The functions of Exchange banks are:

(ii) To supply finance for imports and exports.

(ii) To purchase and discount bills of exchange drawn by Indian exporters and also collect on maturity the proceeds of bills drawn on Indian Importers for goods purchased by them.

(iii) To act as referees, collecting and supplying information about the foreign customers, etc.

A few foreign exchange banks in India are:

(i) The National and Grindlay Bank.

(ii) Lloyds Bank.

(iii) The Mercantile Bank.

If an exporter in Bangalore requires finance to move goods from Bangalore to Bombay port and from there to New York, he may enter into agreement with an exchange bank for financing the movement of his goods.

(iv) Central Banks:
Central Bank of a country is an apex monetary and banking institution that controls the supply of currency in that country. Central bank is entrusted with the duty of regulating the volume of currency and credit in the country. Central bank controls the banking structure of country. Central bank controls and regulates the monetary, banking and credit policies of the country.

Central bank determines the quantum of money which should be circulated in the country. Central bank performs general banking and agency services for the Government. All the banks keep reserves with the Central Bank and banking policies in the country are framed by it. Whereas the object of a commercial bank is to earn profit, a central bank stimulates growth of the country.

Whereas a commercial bank deals with public directly, a central bank deals with commercial banks and other institutions and the government of the country. The central bank is the custodian of the foreign exchange reserves of the country. The central bank controls and regulates credit and currency with a view to stabilize prices in the country. The central bank pumps in more money when the market is short of cash and pumps out money when there is an excess of credit.

(v) The Reserve Bank of India:

Reserve Bank of India was established as the central bank of the country on April 1, 1935, though the idea existed since 1836. As the Central bank of the country, the Reserve Bank is the banker to the banks also. The Reserve Bank regulates the entire banking system of the country.

It regulates the issue of bank notes and the keeping of reserves with a view to secure monetary stability in India and generally to operate the currency and credit system of the country to its advantage. It has also been given the power to pursue an appropriate credit policy. It has control over the cash reserves of the commercial banks. The Reserve Bank has also been given the power to issue license to the banking companies in the country.

The Reserve Bank is required to remove structural instability of the banking system and to provide leadership to the money market. The Reserve Bank was nationalised with the passing of an act in 1948. The entire share capital of the bank was acquired by the Central Government w.e.f. Jan 1, 1949 and the Reserve Bank started functioning as a state-owned and state-controlled institution.

The affairs of Reserve Bank are controlled by the Central Board of Directors consisting of twenty members. There are one Governor, four deputy governors, fourteen Directors and one Government official nominated by the Central Government.

For performing its function, the Reserve Bank consists of the following departments:

(a) Issue department. It has the sole right of note issue which must be backed by gold and sterling securities to the extent of 40%.

(b) Banking department. It is authorized to accept money on deposit without interest, to purchase, sell and rediscount trade bills and bills against Government securities maturing within 90 days and bills against agricultural crops maturing within 9 months; to purchase and sell to member banks, sterling and to regulate credit in the interest of trade and industry.

(c) Exchange control department. It controls foreign exchange transaction and maintains a stable rate of exchange.
(d) Department of Banking Operations and Development extends banking facilities to semi-urban areas and keeps solving the problems of rural finance.

(e) Industrial Finance Department has been entrusted with all matters pertaining to industrial finance including the activities of state financial corporations.

(f) Research and Statistics Department acts as an agency for the collection and dissemination of financial information and statistics in India and abroad.

(g) Legal Department gives legal advice on various matters referred to it by other departments of the bank.

(h) Departments of Financial Companies regulates the acceptance of deposits by non-banking companies.

(i) Department of Accounts and Expenditure maintains and supervises Reserve Bank’s accounts in the Issue and Banking Department.

(j) Inspection Department carries out periodic internal inspection of different offices and departments of the Reserve Bank.

(k) Department of Administration and Personnel deals with general administration, training of staff and employer-employee relations.

(l) Secretary’s Department deals with policy matters relating to open market operations, floatation of Government loans and treasury bills and the Reserve Bank’s dealings with international financial organisations.

Organizational Structure and Role of Banks in India

Banking Regulation Act of India, 1949 defines Banking as “accepting, for the purpose of lending or of investment of deposits of money from the public, repayable on demand or otherwise or withdrawable by cheque, draft order or otherwise.” The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949, govern the banking operations in India.

Organizational Structure of Banks in India:

In India banks are classified in various categories according to different criteria. The following figure indicate the banking structure:

1. The Reserve Bank of India (RBI): The RBI is the supreme monetary and banking authority in the country and has the responsibility to control the banking system in the country. It keeps the reserves of all scheduled banks and hence is known as the “Reserve Bank”.

2. Public Sector Banks:

   State Bank of India and its Associates
   Nationalized Banks
   Regional Rural Banks Sponsored by Public Sector Banks

3. Private Sector Banks:

   Old Generation Private Banks
Foreign New Generation Private Banks
Banks in India
4. Co-operative Sector Banks:

State Co-operative Banks
Central Co-operative Banks
Primary Agricultural Credit Societies
Land Development Banks
State Land Development Banks
5. Development Banks: Development Banks mostly provide long term finance for setting up industries. They also provide short-term finance (for export and import activities)

Industrial Finance Co-operation of India (IFCI)
Industrial Development of India (IDBI)
Industrial Investment Bank of India (IIBI)
Small Industries Development Bank of India (SIDBI)
National Bank for Agriculture and Rural Development (NABARD)
Export-Import Bank of India
Role of Banks:

COMMERCIAL BANKS IN INDIA: ROLE, STRUCTURES AND IMPORTANCE!

1. Role and Importance of Commercial Banks:
The functions of commercial banks explain their importance in the economic development of a country.

Banks help in accelerating the economic growth of a country in the following ways:

1. Accelerating the Rate of Capital Formation:
Commercial banks encourage the habit of thrift and mobilise the savings of people. These savings are effectively allocated among the ultimate users of funds, i.e., investors for productive investment. So, savings of people result in capital formation which forms the basis of economic development.

2. Provision of Finance and Credit:
Commercial banks are a very important source of finance and credit for trade and industry. The activities of commercial banks are not only confined to domestic trade and commerce, but extend to foreign trade also.

3. Developing Entrepreneurship:

Banks promote entrepreneurship by underwriting the shares of new and existing companies and granting assistance in promoting new ventures or financing promotional activities. Banks finance sick (loss-making) industries for making them viable units.

4. Promoting Balanced Regional Development:
Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.
5. Help to Consumers:
Commercial banks advance credit for purchase of durable consumer items like Vehicles, T.V., refrigerator etc., which are out of reach for some consumers due to their limited paying capacity. In this way, banks help in creating demand for such consumer goods.

2. Structure of Commercial Banks in India:
The commercial banks can be broadly classified under two heads:

Commercial Banks

1. Scheduled Banks:
Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934.

In India, scheduled commercial banks are of three types:

(i) Public Sector Banks:
These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks.

Public sector banks are of two types:

(a) SBI and its subsidiaries;
(b) Other nationalized banks.

(ii) Private Sector Banks:
These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank is some examples of private sector banks.

(iii) Foreign Banks:
These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

2. Non-Scheduled Banks:
Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934.

SPECIALIZED FINANCIAL INSTITUTIONS IN INDIA

Specialized Financial Institutions in India make an important segment amongst all the financial institutions in India. The Indian financial institutions are governed under the regulations of both the state and central governments.

The governments on the other hand use them in structuring the planning and development of the country.
With the help of these financial institutions, the government takes up projects and tasks in order to enhance the overall economic scenario of the country. Depending on the economic importance of the financial organizations, all the financial institutions of India can be divided under following categories:

- Specialized Financial Institutions in India
- All-India Development Banks
- State-level institutions
- Investment Institutions
- Other institutions

List of top four specialized banks of India:
- 1. Industrial Development Bank of India
- 2. Housing Finance Bank
- 3. EXIM Bank
- 4. Rural Credit Bank

Specialized Bank # 1. Industrial Development Bank of India:
The Industrial bank of India popularly known as IDBI was established as wholly owned subsidiary of RBI. It was set up under the Act of Parliament in July 1964 to serve the purpose of providing credit and other facilities to the Industry.

Although there were many other institutions which were providing financial help and credit to develop the industrial sector in the country but the growth and development of Industrial sector was in its initial stage of development.

The main reason was lack of co-ordination among the different Institutes which were engaged in providing credit to Industries. As such in February 1976 the ownership of IDBI was transferred to the Government of India and was delinked from RBI. After such transfer the IDBI became the main Institute to Co-ordinate the activities of all such institutions which were engaged in financing, promoting and developing Industry.

In January 1992 the bank accessed domestic retail debt market. In 1993 it set up its wholly owned subsidiary known as IDBI Capital market sendees Ltd. As a policy the RBI had decided to open domestic banking sector to private participation. Following the RBI policy the IDBI in association with SIDBI opened IDBI Bank Ltd.

In September 1994 and next year public issue of the bank was taken out in July 1995. With the result Government share holding in the bank was reduced but retained majority of shareholding. The bank showed good results and it took over the Tata Home Finance Ltd. in September 2003 and renamed it as IDBI Home Finance Ltd.

In the year of 2005 the IDBI bank was merged with Industrial Development bank of India and in 2006 it acquired United Western Bank. The main function and role of development financing is continued by the bank. It re-finances the loans given by Scheduled Banks, State Co-operative banks, IFCI, SFCs and other financial institutions.

Specialised Bank # 2. Housing Finance Bank:
Housing Finance in India had been core issue for general public to obtain a Housing Loan either from Nationalised Banks or from other Financial institutions. The gap was generally and to little extend was fulfilled by state financial corporations, Co-operative banks/societies.

But during seventh Five Year Plan the matter was taken up by a committee constituted under the chairmanship of Dr. C. Rangarajan the then Deputy Governor of Reserve Bank of India observed and examined non-availability of long term finance to individual households on any significant scale as a
major lacuna impeding progress of Housing Sector and they therefore recommended setting up of National level institution.

The RBI therefore recommended setting up of National Housing Bank. The Government accepted the proposal and National Housing Bank was set up on 9th July, 1988 under the National Housing Bank Act 1887 as an apex level institution for housing.

The basic functions of National Housing banks are described in the preamble of the National Housing Bank Act 1887:

“......... to provide as a principal agency to promote housing finance institutions both at local and regional levels to provide financial and other support to such institutions and for matters connected therewith or incidental thereto.........”

NHB has been established to achieve inter alia, the following objectives:

a) To promote a sound, healthy viable and cost effective housing finance system to cater to all segments of the population and to integrate the housing finance system with the overall financial system.

b) To promote a network of dedicated housing finance institutions to adequately serve various regions and different income groups.

c) To augment resources for the sector and channelise them for housing.

d) To make housing finance more affordable.

e) To regulate the activities of housing finance companies based on regulatory and supervisory authority derived under the Act.

f) To encourage augmentation of supply of buildable land and also building materials for housing and to upgrade the housing stock in the country.

g) To encourage public agencies to emerge as facilitators and suppliers of serviced land for housing.

Specialised Bank # 3. EXIM Bank:
The Export and Import Bank of India popularly known as EXIM Banks was established in 1982 under the Export-Import Bank of India Act 1981 mainly for the purpose of enhancing export trade of the country.

In addition to this the bank is required to integrate the country’s foreign trade and investment with overall economic growth Like other Export Credit Agencies the Exim bank has been engaged in providing services like Export Credit, Import Credit, Project financing and credit to export units etc.

In brief the main functions of the bank can be summed up:

Line of Credit:

1. Line Credit.
2. Buyer’s Credit.

3. Supplier’s Credit.

4. Pre-shipment and Post-shipment Credit.

Import Credit:

1. Import Loans for capital goods.

2. Bulk Import Loans for raw materials.

Loans for Export Units:

1. Term Loan (Rs. & $) for expansion/diversification/New Projects.

2. Term Loan (Rs.) for overseas equity investments.

3. Term Loan (Rs. & $) for export development/Export marketing/Research & developments.

Projects and Services Export:

These are categorized broadly into:

1. Civil engineering construction projects.

Turnkey Projects:

1. Consultancy Services.


The Exim Bank’s functions are divided into several operating groups including:

Corporate Banking Group:

Which handles a variety of financing programmes for Export Oriented Units (EOUs), Importers, and overseas investment by Indian companies.

Project Finance/Trade Finance Group:

Handles the entire range of export credit services such as supplier’s credit, pre-shipment credit, buyer’s credit, finance for export of projects & consultancy services, guarantees etc.

Lines of Credit Group Lines of Credit (LOC) is a financing mechanism that provides a safe mode of non-recourse financing option to Indian exporters, especially to SMEs, and serves as an effective market entry tool.

Agri Business Group, to spearhead the initiative to promote and support Agri-exports. The Group handles projects and export transactions in the agricultural sector for financing.
Small and Medium Enterprises Group to the specific financing requirements of export oriented SMEs. The group handles credit proposals from SMEs under various lending programmes of the Bank.

Export Services Group offers variety of advisory and value-added information services aimed at investment promotion.

Fee based Export Marketing Services Bank offers assistance to Indian companies, to enable them establish their products in overseas markets.

Besides these, the Support Services groups, which include: Research & Planning, Corporate Finance, Loan Recovery, Internal Audit, Management Information Services, Information Technology, Legal, Human Resources Management and Corporate Affairs.

Specialised Bank #4. Rural Credit Bank:
The rural credit has been managed in many ways. The system of providing credit for rural development had been looked after by RBI, NABARD, Commercial banks, State Co-operative banks, District co-operative banks and Primary Agricultural Credit societies. But our economy had been lacking a developed Rural Financial system.

In fact with introduction of Co-operatives a formal credit structure for financing agriculture and other rural activities was started in India. With start of Plan era great importance was given to this so far neglected area. The All India Rural Credit Survey Committee (AIRCS) 1954, emphasized for proper development of institutional credit structures for rural financing.

Many other also recommended many more developments like Priority sector lending, lead banks scheme, service area approach, setting up of NABARD etc., are some of outcomes of the repeated review of the system.

Another committee known as Agriculture Credit Review committee (ACRC) 1989 after examination of problems of rural credit recommended greater autonomy for commercial banks, the weakness of RRBs was seen in the system with the non-viability built into them. The co-operatives were sought to be strengthened.

The Narsimham committee on Financial Sector Reforms 1991 inter alia recommended a redefinition of priority sector, gradual phasing out of direct credit programs of aggregate bank credit and deregulation of interest rates.

The institutions thus created, with repeated review of the rural banking, emerged as:

1. RBI-NABARD.

2. Commercial Banks.

3. State Co-operative Banks, District co-operative banks.

4. Primary Agriculture societies.

The routing funds through above institutes have tended to unduly increase the cost of banking. High over dues, bad debts, loan defaults, unviability etc.
Most important role of Rural Credit is being played even today by the Co-operative banks which provide loans for farming, Cattle, hatchery and also for personal needs.

Financial Institutions:
Finance Corporation of India (IFCI)
Industrial Credit and Investment Corporation of India (ICICI)
State Financial Corporations (SFCs)
State Industrial Development Corporations (SIDC’S)
Industrial Development Bank of India (IDBI)
Industrial Investment Bank of India (IIBIL)
Unit Trust of India (UTI)
Small Industries Development Bank of India (SIDBI)

Financial Institution # 1. Industrial Finance Corporation of India (IFCI):
The Industrial Finance Corporation of India was established in 1948 under the IFC Act, 1948. The main objective of the corporation has been to provide medium and long-term credit to industrial concerns in India.

The financial assistance of the corporation is available to limited companies or co-operative societies registered in India and engaged or proposing to engage in:

(a) Manufacture, preservation or processing of goods

(b) The mining industry;

(c) The shipping business;

(d) The hotel industry; and

(e) The generation or distribution of electricity or any other form of power.

Initially the authorised capital of the corporation was Rs. 10 crore which was divided in equities of Rs. 5,000 each. Later on the authorised capital was increased to Rs. 20 crore. Since July 1, 1993 this corporation has been converted into a company and it has been given the status of a limited company with the name Industrial Finance Corporation of India Ltd. IFCI has got its registration under Companies Act, 1956.

Before July 1, 1993, general public was not permitted to hold shares of IFCI. Only Government of India, RBI, Scheduled Banks, Insurance Companies and Co-operative Societies were holding the shares of IFCI.

The financial resources of IFCI consist of paid-up capital, reserves, repayment of loans, market borrowings in the form of bonds/debentures, loans from Government of India, advances from the Industrial Development Bank of India and foreign currency loans.

**Functions of IFCI:**

The functions of the IFCI can be broadly classified into:

a. Financial Assistance, and

b. Promotional Activities.
a. Financial Assistance:

The IFCI is authorised to render financial assistance in one or more of the following forms:

(i) Granting loans or advances to or subscribing to debentures of industrial concerns repayable within 25 years. Also it can convert part of such loans or debentures into equity share capital at its option.

(ii) Underwriting the issue of industrial securities i.e., shares, bonds, or debentures to be disposed off within 7 years.

(iii) Subscribing directly to the shares and debentures of public limited companies.

(iv) Guaranteeing of loans raised by industrial concerns from scheduled banks or state co-operative banks.

(v) Guaranteeing of deferred payments for the purchase of capital goods from abroad or within India.

(vi) Acting as an agent of the Central Government or the World Bank in respect of loans sanctioned to the industrial concerns.

Financial assistance is available from IFCI for the following purposes:

(i) For the setting up of new industrial undertakings.

(ii) For expansion or diversification of the existing concerns.

(iii) For the modernisation and renovation of the existing concerns.

(iv) For meeting existing liabilities or working capital requirement of industrial concerns in exceptional cases.

IFCI provides financial assistance to eligible industrial concerns regardless of their size. However, now-a-days, it entertains applications from those industrial concerns whose project cost is above Rs. 2 crores because up to project cost of Rs. 2 crores various state level institutions (such as Financial Corporations, SIDCs and banks) are expected to meet the financial requirements of viable concerns.

While approving a loan application, IFCI gives due consideration to the feasibility of the project, its importance to the nation, development of the backward areas, social and economic viability, etc.

b. Promotional Activities:

The IFCI has been playing very important role as a financial institution in providing financial assistance to eligible industrial concerns. However, no less important is its promotional role whereby it has been creating industrial opportunities also. The corporation discovers the opportunities for promoting new enterprises.

It helps in developing small and medium scale entrepreneurs by providing them guidance through its specialised agencies in identification of projects, preparing project profiles, implementation of the projects, etc. It acts an instrument of accelerating the industrial growth and reducing regional industrial and income disparities.

**Working of IFCI:**
The cumulative financial assistance sanctioned by IFCI up to March, 2003 aggregated Rs. 45,426.7 crores against which disbursements amounted to Rs. 44,169.2 crores. During 2003-04, IFCI sanctioned and disbursed Rs. 1394.6 crore and Rs. 281.2 crore respectively.

However, no amount was sanctioned by IFCI during 2004-05 and disbursements also amounted to Rs. 91 crore only. The provisional disbursement for the year 2005-06 amounted to Rs. 187 crore only.

However, no amount was sanctioned by IFCI during 2004-05 and disbursements also amounted to Rs. 91 crores only. The disbursements for the year 2005-06 amounted to Rs. 187 crores only. The provisional figures of sanctions and disbursements for the year 2006-07 amounted to Rs. 1050 crores and Rs. 550 crores respectively.

The most of the assistance sanctioned by IFCI has gone to industries of national priority such as fertilizers, cement, power generation, paper, industrial machinery etc.

The corporation is giving a special consideration to the less developed areas and assistance to them has been stepped up. It has sanctioned nearly 49 per cent of its assistance for projects in backward districts.

The corporation has recently been participating in soft loan schemes under which loans on concessional rates are given to units in selected industries. Such assistance is given for modernisation, replacement and renovation of plant and equipment.

IFCI introduced a scheme for sick units also. The scheme was for the revival of sick units in the tiny and small scale sectors. Another scheme was framed for the self-employment of unemployed young persons. The corporation has diversified into merchant banking also. Financing of leasing and hire purchase companies, hospitals, equipment leasing etc. were the other new activities of the corporation in the last few years.

Financial Institution # 2. Industrial Credit and Investment Corporation of India (ICICI):
The Industrial Credit and Investment Corporation of India (ICICI) were established in 1955 as a public limited company under the Indian Companies Act for developing medium and small industries of private sector.

Initially its equity capital was owned by companies, institutions and individuals but at present its equity capital is owned by public sector institutions like banks, LIC and GIC etc. It provides term loans in Indian and foreign currencies, underwrites issues of shares and debentures, makes direct subscription to these issues and guarantees payment of credit made by others.

**Functions of ICICI:**

The corporation has been established for the purpose of assisting industries in the private sector by undertaking the following functions:

(i) Assisting in the creation, expansion and modernisation of such enterprises.

(ii) Encouraging and promoting the participation of private capital, both internal and external.

(iii) Encouraging and promoting private ownership.

(iv) Expansion of investment market.
(v) Providing finance in the form of long or medium-term loans.

(vi) Underwriting issue of shares and debentures.

(vii) Making funds available for re-investment.

(viii) Furnishing managerial, technical and administrative services to Indian Industry.

(ix) To extend guarantee for deferred payments.

(x) To advance loans in foreign currency towards the cost of imported capital equipment.

The financial assistance sanctioned and disbursed by ICICI up to March 2002 amounted to Rs. 2,83,511 crore and Rs. 1,71,698 crore respectively. During 1998-99 alone it sanctioned Rs. 34,220 crore and disbursed Rs. 19,225 crore.

Loans sanctioned in foreign currency constitute important place in total sanctioned loans of the corporation. The assistance sanctioned and disbursed by ICICI during 2001-02 aggregated Rs. 35,589 crores and Rs. 25,050 crores respectively registering a growth of 36.2% and 20.9% respectively over the previous year.

Recently ICICI Ltd. (along with two its subsidiaries, ICICI Personal Finance Services Ltd., and ICICI Capital Services Ltd.) has been merged with ICICI Bank Ltd., effective from May 3, 2002. The erstwhile DFI has thus ceased to exist.

Financial Institution # 3. State Financial Corporations (SFCs):
The State Financial Corporation Act was passed by the Government of India in 1951 with a view to provide financial assistance to small and medium scale industries which were beyond the scope of IFCI. According to this Act, a State Government is empowered to establish a financial corporation to operate within the State. At present, there are 18 such corporations functioning in the country.

These corporations are expected to be complementary to the Industrial Finance Corporation of India. While IFCI provides assistance only to large industrial concerns owned by public limited companies or co-operatives, the SFCs render assistance to all kinds of industries, may be in the form of private limited companies, partnership firms or sole-trading concerns.

The capital structure of the State Financial Corporations has been left to be determined by State Government within the limits of Rs. 50 lakhs to Rs. 5 crores, 25 per cent of the capital can be subscribed by the public and the rest by the State Government, the Reserve Bank of India, insurance companies and other institutional investors in proportion to be determined by the State Government in consultation with the Reserve Bank of India.

Apart from share capital, the SFCs depend for financial resources on issue of bonds, borrowings from RBI, loans from State Government, refinancing of loans by IDBI, deposits from the public, repayment of loans and income from investments.

**Functions:**
The main function of the SFCs is to provide loans to small and medium scale industries engaged in the manufacture, preservation or processing of goods, mining, hotel industry, generation or distribution of power, transportation, fishing, assembling, repairing or packaging articles with the aid of power, etc.

State Financial Corporations are authorised to grant financial assistance in the following forms:

(i) Granting of loans or advances to industrial concerns repayable within a period not exceeding twenty years.

(ii) Subscribing to the debentures of industrial concerns repayable within a period not exceeding twenty years.

(iii) Guaranteeing loans raised by industrial concerns repayable within twenty years.

(iv) Underwriting the issue of stocks, shares, bonds or debentures by the industrial concerns subject to their being disposed off within seven years.

(v) Guaranteeing deferred payments due from any industrial concern in connection with purchase of capital goods in India.

(vi) Acting as an agent of the Central Government or State Government or the Industrial Finance Corporation of India in respect of any business with an industrial concern in respect of loans sanctioned to them.

Financial Institution # 4. State Industrial Development Corporations (SIDC’S):
In order to accelerate industrial development various states have set up Industrial Development Corporations. Andhra Pradesh and Bihar were the first states to set up such corporations in 1960. Most of the states have set up such institutions at present. At present there are 28 such SIDCs working in the country.

Many of these corporations are registered under Companies Act and two have been set up under the statutes of legislative bodies. These corporations are wholly owned by state governments.

SIDCs perform the following functions:

(i) Grant of financial assistance.

(ii) Provision of industrial sheds or plots.

(iii) Promotion and management of industrial concerns.

(iv) Promotional activities such as identification of project idea, selection and training of entrepreneur, provision of technical assistance during project implementation.

(v) Providing risk capital to entrepreneur by way of equity participation and seed capital assistance.

Financial Institution # 5. Industrial Development Bank of India (IDBI):
The Industrial Development Bank of India was established under the Industrial Development Bank of India Act, 1964 as a wholly owned subsidiary of the Reserve Bank of India. The ownership of IDBI has since been transferred to Central Government from February 16, 1976.
The main object of establishing IDBI was to set up an apex institution to co-ordinate the activities of other financial institutions and to act as a reservoir on which the other financial institutions can draw. IDBI provides direct financial assistance to industrial units also to bridge the gap between supply and demand of medium and long term finance.

As on March 31, 1997, the paid up capital of IDBI stood at Rs. 659.4 crore and reserve funds at Rs. 6554 crore. The bank is also authorised to raise its resources through borrowings from Government of India, Reserve Bank of India and other financial institutions.

On 31st March, 1997, the bank had borrowings of Rs. 23,802 crore by way of bonds and debentures, deposits of Rs. 3694 crore and borrowings of Rs. 10,364 crore from RBI, Government of India and other sources.

Functions:

The main functions of IDBI are as follows:

i. To co-ordinate the activities of other institutions providing term finance to industry and to act as an apex institution.

ii. To provide refinance to financial institutions granting medium and long-term loans to industry.

iii. To provide refinance to scheduled banks or co-operative banks.

iv. To provide refinance for export credits granted by banks and financial institutions.

v. To provide technical and administrative assistance for promotion, management or growth of industry.

vi. To undertake market surveys and techno-economic studies for the development of Industry.

vii. To grant direct loans and advances to industrial concerns, IDBI is empowered to finance all types of industrial concerns engaged or proposed to be engaged in the manufacture, preservation or processing of goods, mining, hotel industry, fishing, shipping, transport, generation or distribution of power, etc.

The bank can also assist concerns engaged in the setting up of industrial estates or research and development of any process or product or in providing technical knowledge for the promotion of industries. Until recently IDBI also functioned as Export-Import Bank of the country.

viii. To render financial assistance to industrial concerns, IDBI operates various schemes of assistance, e.g., Direct Assistance Scheme, Soft Loans Scheme, Technical Development Fund Scheme, Refinance Industrial Loans Scheme, Bill Re-discounting Scheme, Seed Capital Assistance Scheme, Overseas Investment Finance Scheme, Development Assistance Fund, etc.

Since its inception in 1964, IDBI has extended its operations to various areas of industrial sector. It provides direct loans, refines industrial loans, rediscounts bills, underwrites shares and debentures, directly subscribes to shares and debentures of companies of industrial units etc.

Aggregate assistance sanctioned by March 2003 amounted to Rs. 2,23,932 crore and disbursements amounted to Rs. 1,68,167 crore. Assistance sanctioned during 2004-05 amounted to Rs. 10,799 crore and disbursements amounted to Rs. 6,183 crore in 2004-05. The provisional figures for the year 2005-06 amounted to Rs. 27,442 crore and Rs. 12,984 crore respectively.
Financial Institution # 6. Industrial Investment Bank of India (IIBIL):
Industrial Reconstruction Bank of India (IRBI):

IRBI was established on March 20, 1985 under Indian Industrial Reconstruction Bank Act, 1984 as a result of reconstituting Indian Industrial Reconstruction Corporation. The basic aim of establishing IRBI was to revive sick and closed industrial units and to act as prime loan and reconstruction agency.

IRBI has been rechristened as Industrial Investment Bank of India Ltd. (IIBIL) with effect from March 27, 1997. The authorised capital of IIBIL is Rs. 1,000 crore and its head office is situated at Calcutta. Now it acts as an autonomous development finance institution like IFCI, ICICI and IDBI. During 1999-2000, IIBIL sanctioned and disbursed Rs. 2338.08 crore and Rs. 1439.58 crore respectively.

The figures for the year 2000-01 amounted to Rs. 2102.3 crore and Rs. 1709.8 crore respectively; and for the year 2001-02, sanctions amounted to Rs. 1320.7 crore against disbursements of Rs. 1070 crore. The provisional figures for the year 2002-03 amounted to Rs. 12.06.4 crore and Rs. 1091.9 crore and for the year 2003-04 sanctions amounted to Rs. 2,412 crore against disbursements of Rs. 2,252 crore.

Financial Institution # 7. Unit Trust of India (UTI):
The Unit Trust of India was established on February 1. 1964 under the Unit Trust of India Act, 1963 with the following objectives:

(i) To stimulate and pool the savings of the middle and low income groups.

(ii) To enable unit holders to share the benefits and prosperity of the rapidly growing industrialisation in the country.

(iii) To sell units among as many investors as possible.

(iv) To invest the money raised from the sale of units and its own capital in corporate and industrial securities.

(v) To pay dividend to the unit holders.

With the amendment of UTI Act in April, 1986, UTI is now allowed to grant term loans, rediscount bills, undertake equipment leasing and bill purchase financing, provide housing and construction finance, provide merchant banking and portfolio management services and set up overseas funds. UTI mobilises saving funds from public by selling its units in various schemes.

The mobilised sources are invested by the Trust in shares and debentures of various well established companies.

UTI distributes its net profit amongst its unit holders as dividend. Presently UTI is the largest investor in Indian share market. As on July 31, 2002 UTI’s assets under management were valued at Rs. 47,787 crore. Financial assistance sanctioned and disbursed by UTI during 2000-01 stood at Rs. 6770 crore and Rs. 4600 crore respectively.

The head office of the UTI is situated at Mumbai and its regional offices are working at Mumbai, Calcutta, Chennai and New Delhi. 41 branches of UTI are working in various parts of the country. UTI has also established a private sector bank named UTI Bank Ltd.
Financial Institution # 8. Small Industries Development Bank of India (SIDBI):
The Small Industries Development Bank of India (SIDBI) was set up in 1990 under the SIDBI Act, 1990. The main objective of SIDBI has been to work as a principal financial institution for the promotion, financing and development of industries in the small-scale sector.

It is also expected to co-ordinate the functions of various financial institutions, such as, State Financial Corporations, State Small Industries Development Corporations. Scheduled Banks and State Co-operative Banks, etc. engaged in the financing, promotion and development of small-scale industries.

Resources:
The financial resources of SIDBI mainly comprise contribution from the Industrial Development Bank of India (IDBI) in the form of share capital and loans, funds from the Reserve Bank of India, loans from the Government of India and the market borrowings. The authorised capital of SIDBI is Rs. 250 crores which may be increased to Rs. 1000 crores. It is also free to obtain loans in foreign currency from foreign institutions.

Working:
The Small Industries Development Bank of India began its operations in April 1990 by taking over the activities of the IDBI relating to the small-scale industrial sector. Since, then it has been providing very useful service to the small-scale industries. The other specialised financial institutions were generally providing assistance only to the big industrial units and hence SIDBI has filled this gap very well.

Total financial assistance sanctioned and disbursed by SIDBI till the end of March, 1999 stood at Rs. 45,137 crore and Rs. 32,985 crore respectively. During 2001-02 sanctions and disbursements made by SIDBI were Rs. 9,014 crore and Rs. 5,197 crore respectively.

In pursuance of SIDBI (Amendment) Act, 2000, 51% of shareholding in SIDBI hither to subscribed and held by IDBI, have been transferred to select public sector banks, LIC, GIC and other institutions owned or controlled by the Central Government.

The list of specialized financial institutions in India mainly includes, Export-Import Bank Of India, Board for Industrial & Financial Reconstruction, Small Industries Development Bank of India, National Housing Bank. They are government undertakings established with a view to offer financial as well as technical assistance to the Indian industries.

Export-Import Bank Of India

The Export-Import Bank Of India ranks high among the specialized financial institutions in India.

It was set up in the year 1981 to enhance International Trade in India with the aid of a two-way approach. It offers financial assistance to the exporters and importers and also by acting as a link between the various financial institutions to ensure overall development of the Indian financial market. The bank offers financial assistance to the various sectors like agriculture, export, import, and film industry. For the agricultural sector the bank has arranged for unique financial programs like posting shipment credit, terming loans etc. The category of term loans are issued for modernization, purchase of equipments, acquisitions etc. For the exporters the bank provides warehousing finance, export lines of credit facilities. The funded capital scheme of the bank includes long-term working capital, cash flow financing, and the non funded capital scheme include letter of credit limits, guarantee limits. For the film industry the bank has arranged for cash flow financing for film production, funds for exhibition in overseas market. The
bank is engaged in offering specialized services Human Resource Management, Research and Planning, Internal Audit etc. The Export-Import Bank Of India has set up offices throughout India and in foreign countries as well. The head office is located at Mumbai and Shri. T. C. Venkat Subramanian acts as the Chairman and Managing Director of the bank.

Small Industries Development Bank of India

The Small Industries Development Bank of India also ranks high among the specialized financial institutions in India. It was founded in the year 1990 to develop the small-scale industry in India with the aid of advisory services. The bank offers financial assistance to the small and medium scale industries and coordinated the functioning of other financial institutions that caters to the need of the agro-industries in India. The Small Industries Development Bank of India offers financial assistance for significant issues like infrastructure development, rehabilitation for sick industrial units. The investors can take the advantage of the unique fixed deposit scheme offered the bank. For the recently launched companies the bank provides composite loan, technology upgradation fund, direct credit scheme etc. The existing members are allowed direct credit scheme, credit linked capital subsidy etc. For the upgradation of the standard of Indian women and to help them achieve financial independence the bank offers two specialized financial program named as marketing fund for women and Mahila Udyam Nidhi. The bank is located at Lucknow and Shri Rajender Mohan Malla acts as its Chairman and managing director.

National Housing Bank

The National Housing Bank was established in the year 1988 as per the guidelines of the National Housing Bank Act, 1987 with a view to accelerate the growth of the Housing Financing Institutions by providing them with financial and other required assistance. The company extends financial assistance for entire infrastructural development offers refinance to the existing housing finance companies etc. The bank has set up specialized divisions like Development and Risk Management, Project Finance, Refinancing Operations, Resource Mobilization and Management etc. The head office is located at New Delhi and Shri S. Sridhar acts as the Chairman & Managing Director of the bank.

Board for Industrial & Financial Reconstruction

The Board for Industrial & Financial Reconstruction was set up in the year 1987 in order to advise on all the aspects that need to be upgraded for a sick industrial unit. The Sick Industrial Companies (Special Provisions) Act, 1985 guides the activities of the board. The board assesses the type of sickness and the industrial units that eligibility criteria. The main eligibility criteria for the companies are that they should be registered under the Companies Act for at least 5 years.

The bank is located at Jawahar Vyapar Bhawan, 1, Tolstoy Marg, New Delhi and Shri A.K. Goswami acts as its Chairman.

Financial Institutions in India

- Commercial Banks
- Insurance Companies
- Credit rating agencies
- Finance Minister
- The New Role of Finance
- Finance and India's Development
- Micro Finance
- Specialized Financial Institutions
- Online Services Ministry
UNIVERSAL BANKING

What is 'Universal Banking'
Universal banking is a system in which banks provide a wide variety of financial services, including commercial and investment services. Universal banking is common in some European countries, including Switzerland. In the United States, however, banks are required to separate their commercial and investment banking services. Proponents of universal banking argue that it helps banks better diversify risk. Detractors think dividing up banks' operations is a less risky strategy.

BREAKING DOWN 'Universal Banking'
Universal banks may offer credit, loans, deposits, asset management, investment advisory, payment processing, securities transactions, underwriting and financial analysis. While a universal banking system allows banks to offer a multitude of services, it does not require them to do so. Banks in a universal system may still choose to specialize in a subset of banking services.

Universal banking combines the services of a commercial bank and an investment bank, providing all services from within one entity. The services can include deposit accounts, a variety of investment services and may even provide insurance services. Deposit accounts within a universal bank may include savings and checking.

Under this system, banks can choose to participate in any or all of the permitted activities. They are expected to comply with all guidelines that govern or direct proper management of assets and transactions. Since not all institutions participate in the same activities, the regulations in play may vary from one institution to another.

It is important not to confuse the term "universal bank" with any financial institutions with similar names.

Universal Banking in the United States
Due to strict regulation, the universal bank is was a common occurrence within the United States. This is due to the Glass-Steagall Act of 1933. Recent developments have removed a number of the barriers to the creation of a universal bank, though they are still not as prevalent as they are across many European countries. Further, the United States has banks that focus purely on investments, which is highly uncommon in the rest of the world.

Impact of the 2008 Financial Crisis
The 2008 financial crisis led to a number of failures within the investment banking system in the United States. This led to the acquisition or bankruptcy of a variety of institutions. Some notable examples include Lehman Brothers and Merrill Lynch.

Examples of Universal Banks
Some of the more notable universal banks include Deutsche Bank, HSBC and ING Bank. Within the United States, Bank of America, Wells Fargo and JPMorgan Chase qualify as universal banks.

DEFINITION OF 'SECURITIZATION'

Definition: Securitization is a process by which a company clubs its different financial assets/debts to form a consolidated financial instrument which is issued to investors. In return, the investors in such securities get interest.

Description: This process enhances liquidity in the market. This serves as a useful tool, especially for financial companies, as its helps them raise funds. If such a company has already issued a large number of loans to its customers and wants to further add to the number, then the practice of securitization can come to its rescue.
In such a case, the company can club its assets/debts, form financial instruments and then issue them to investors. This enables the firm to raise capital and provide more loans to its customers. On the other hand, investors

Securitization

**WHAT IS 'SECURITIZATION'**

Securitization is the procedure whereby an issuer designs a financial instrument by merging various financial assets and then markets tiers of the repackaged instruments to investors. This process can encompass any type of financial asset and promotes liquidity in the marketplace.

**What is RTGS System?**

The acronym 'RTGS' stands for Real Time Gross Settlement, which can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at the time they are received rather than at some later time; 'Gross Settlement' means the settlement of funds transfer instructions occurs individually (on an instruction by instruction basis). Considering that the funds settlement takes place in the books of the Reserve Bank of India, the payments are final and irrevocable.

**How RTGS is different from National Electronics Funds Transfer System (NEFT)?**

Ans. NEFT is an electronic fund transfer system that operates on a Deferred Net Settlement (DNS) basis which settles transactions in batches. In DNS, the settlement takes place with all transactions received till the particular cut-off time. These transactions are netted (payable and receivables) in NEFT whereas in RTGS the transactions are settled individually. For example, currently, NEFT operates in hourly batches. [There are twelve settlements from 8 am to 7 pm on week days and six settlements from 8 am to 1 pm on Saturdays.] Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time Contrary to this, in the RTGS transactions are processed continuously throughout the RTGS business hours.

**Is there any minimum / maximum amount stipulation for RTGS transactions?**

The RTGS system is primarily meant for large value transactions. The minimum amount to be remitted through RTGS is ` 2 lakh. There is no upper ceiling for RTGS transactions.

**What is the time taken for effecting funds transfer from one account to another under RTGS?**

Under normal circumstances the beneficiary branches are expected to receive the funds in real time as soon as funds are transferred by the remitting bank. The beneficiary bank has to credit the beneficiary's account within 30 minutes of receiving the funds transfer message.

**Would the remitting customer receive an acknowledgement of money credited to the beneficiary's account?**

The remitting bank receives a message from the Reserve Bank that money has been credited to the receiving bank. Based on this the remitting bank can advise the remitting customer through SMS that money has been credited to the receiving bank.

**Q6. Would the remitting customer get back the money if it is not credited to the beneficiary's account? When?**

Ans. Yes. Funds, received by a RTGS member for the credit to a beneficiary customer’s account, will be returned to the originating RTGS member within one hour of the receipt of the payment at the PI of the recipient bank or before the end of the RTGS Business day, whichever is earlier, if it is not possible to credit the funds to the beneficiary customer’s account for any reason e.g. account does not exist, account frozen, etc. Once the money is received back by the remitting bank, the original debit entry in the customer's account is reversed.

**Till what time RTGS service window is available?**

The RTGS service window for customer’s transactions is available to banks from 9.00 hours to 16.30 hours on week days and from 9.00 hours to 14:00 hours on Saturdays for settlement at the RBI end. However, the timings that the banks follow may vary depending on the customer timings of the bank branches.

**What about Processing Charges / Service Charges for RTGS transactions?**
With a view to rationalize the service charges levied by banks for offering funds transfer through RTGS system, a broad framework has been mandated as under:

a) Inward transactions – Free, no charge to be levied.
b) Outward transactions – ` 2 lakh to ` 5 lakh - not exceeding ` 30.00 per transaction;
   Above ` 5 lakh – not exceeding ` 55.00 per transaction.

**What is the essential information that the remitting customer would have to furnish to a bank for the remittance to be effected?**

The remitting customer has to furnish the following information to a bank for initiating a RTGS remittance:

1. Amount to be remitted
2. Remitting customer’s account number which is to be debited
3. Name of the beneficiary bank and branch
4. The IFSC Number of the receiving branch
5. Name of the beneficiary customer
6. Account number of the beneficiary customer
7. Sender to receiver information, if any

**How would one know the IFSC number of the receiving branch?**

Ans. The beneficiary customer can obtain the IFSC code from his bank branch. The IFSC code is also available on the cheque leaf. The list of IFSCs is also available on the RBI website (http://rbidocs.rbi.org.in/rdocs/RTGS/DOCs/RTGEB0815.xlsx). This code number and bank branch details can be communicated by the beneficiary to the remitting customer.

**Do all bank branches in India provide RTGS service?**

Ans. No. All the bank branches in India are not RTGS enabled. Presently, there are more than 100,000 RTGS enabled bank branches. The list of such branches is available on RBI website at: http://rbidocs.rbi.org.in/rdocs/RTGS/DOCs/RTGEB0815.xlsx.

**Is there any way that a remitting customer can track the remittance transaction?**

Ans. It would depend on the arrangement between the remitting customer and the remitting bank. Some banks with internet banking facility provide this service. Once the funds are credited to the account of the beneficiary bank, the remitting customer gets a confirmation from his bank either by an e-mail or SMS. Customer may also contact RTGS / NEFT Customer Facilitation Centres of the banks, for tracking a transaction.

**Whom do I contact, in case of non-credit or delay in credit to the beneficiary account?**

Ans. Contact your bank / branch. If the issue is not resolved satisfactorily, complaint may be lodged to the Customer Service Department of RBI at:

The Chief General Manager
Reserve Bank of India
Customer Service Department
1st Floor, Amar Building, Fort
Mumbai – 400 001
Or send email

**ECS/NEFT/RTGS ELECTRONIC CLEARING SERVICE (ECS)**

ECS is an electronics mode of payment/receipt for transactions that are repetitive and periodic in nature. ECS is used by institutions for making bulk payment or bulk collection of amounts. Essentially, ECS facilitates bulk transfer of monies from one bank account to many bank accounts or vice versa.

Primarily, there are two variants of ECS - ECS Credit and ECS Debit. ECS Credit is used by an institution for affording credit to a large number of beneficiaries having accounts with bank branches at various locations within the jurisdiction of a ECS Centre by raising a single debit to the bank account of the user.
institution. ECS Credit enables payment of amounts towards distribution of dividend, interest, salary, pension, etc., of the user institution.

ECS Debit is used by an institution for raising debits to a large number of accounts maintained with bank branches at various locations within the jurisdiction of an ECS Centre for single credit to the bank account of the user institution. ECS Debit is useful for payment of telephone / electricity / water bills, cess / tax collections, loan installment repayments, periodic investments in mutual funds, insurance premium etc., that are periodic or repetitive in nature and payable to the user institution by large number of customers etc. Based on the geographical location of branches covered, there are three broad categories of ECS Schemes – Local ECS, Regional ECS and National ECS

**ECS Credit**

ECS Credit payments can be initiated by any institution (called ECS Credit User) which needs to make bulk or repetitive payments to a number of beneficiaries. The institutional User has to first register with an ECS Centre. The User has to also obtain the consent of beneficiaries (i.e., the recipients of salary, pension, dividend, interest etc.) and get their bank account particulars prior to participation in the ECS Credit scheme. The beneficiary account holders are required to give mandates to the user institutions to enable them to afford credit to their bank accounts through the ECS Credit mechanism. ECS can be used to transfer funds to NRE and NRO accounts in the country subject to FEMA and Wire Transfer guidelines.

**Benefits**

**Beneficiary** –

- The beneficiary need not visit his / her bank for depositing the paper instruments which he would have otherwise received had he not opted for ECS Credit.
- The beneficiary need not be apprehensive of loss / theft of physical instruments or the likelihood of fraudulent encashment thereof.
- **Cost effective.**
- The beneficiary receives the funds right on the due date.

**User Institutions** –

- Savings on administrative machinery and costs of printing, dispatch and reconciliation of paper/instruments that would have been used had beneficiaries not opted for ECS Credit.
- Avoid chances of loss / theft of instruments in transit, likelihood of fraudulent encashment of paper instruments, etc. and subsequent correspondence / litigation.
- **Efficient payment mode ensuring that the beneficiaries get credit on a designated date.**
- **Cost effective.**

**Banking system** –

- Freedom from paper handling and the resultant disadvantages of handling, presenting and monitoring paper instruments presented in clearing. Ease of processing and return for the destination bank branches.
- **Smooth process of reconciliation for the sponsor banks.**
- **Cost effective.**

**ECS Debits**

ECS Debit transaction can be initiated by any institution (called ECS Debit User) which has to receive / collect amounts towards telephone / electricity / water dues, cess / tax collections, loan installment repayments, periodic investments in mutual funds, insurance premium etc. It is a Scheme under which an account holder with a bank branch can authorise an ECS User to recover an amount at a prescribed frequency by raising a debit to his / her bank account.

The User institution has to first register with an ECS Centre. The User institution has to also obtain the authorization (mandate) from its customers for debiting their account along with their bank account particulars prior to participation in the ECS Debit scheme. The mandate has to be duly verified by the beneficiary’s bank.

**Benefits**

**Customers** –

ECS Debit mandates will take care of automatic debit to customer accounts on the due dates without visiting bank branches / collection centres of utility service providers, etc.
• Customers need not keep track of due date for payments.
• The debits to customer accounts would be monitored by the ECS Users, and the customers alerted accordingly.
• Cost effective.

User institutions –
• Savings on administrative machinery and costs of collecting the cheques from customers, presenting in clearing, monitoring their realisation and reconciliation.
• Better cash management because of realisation / recovery of dues on due dates promptly and efficiently.
• Avoids chances of loss / theft of instruments in transit, likelihood of fraudulent access to the paper instruments and encashment thereof.
• Realisation of payments on a uniform date instead of fragmented receipts spread over many days.
• Cost effective.

Banking system –
• Freedom from paper handling and the resultant disadvantages of handling, receiving and monitoring paper instruments presented in clearing.
• Ease of processing and return for the destination bank branches. • Smooth process of reconciliation for the sponsor banks.
• Cost effective.

MICR code
MICR is an acronym for Magnetic Ink Character Recognition. The MICR Code is a numeric code that uniquely identifies a bank-branch participating in the ECS Credit scheme. This is a 9 digit code to identify the location of the bank branch; the first 3 characters represent the city, the next 3 the bank and the last 3 the branch. The MICR Code allotted to a bank branch is printed on the MICR band of cheques issued by bank branches.

NATIONAL ELECTRONIC FUND TRANSFER (NEFT)
National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporate can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. Individuals who do not have a bank account (walk-in customers) can also deposit cash (Max. Rs. 50,000/-) at the NEFT-enabled branches with instructions to transfer funds using NEFT. The NEFT system also facilitates one-way cross-border transfer of funds from India to Nepal. This is known as the IndoNepal Remittance Facility Scheme.

There is no limit on the amount to be transferred either minimum or maximum (except cash based transaction restricted to Rs. 50,000/and remittance to Nepal). There is no restriction of centres or of any geographical area within the country. The NEFT system takes advantage of the core banking system in banks. Presently, NEFT operates in hourly batches - there are eleven settlements from 9 am to 7 pm on week days (Monday through Friday) and five settlements from 9 am to 1 pm on Saturdays. The beneficiary can expect to get credit for the first nine batches on week days (i.e., transactions from 9 am to 5 pm) and the first four batches on Saturdays (i.e., transactions from 9 am to 5 pm) on the same day.

IFSC or Indian Financial System Code is an alphabetic-numeric code that uniquely identifies a bank-branch participating in the NEFT system. This is an 11 digit code with the first 4 alpha characters representing the bank, and the last 6 characters representing the branch. The 5th character is 0 (zero). IFSC is used by the NEFT system to identify the originating / destination banks / branches and also to route the messages appropriately to the concerned banks / branches.
Directed Investment Programme: The committee objected to the system of maintaining high liquid assets by commercial banks in the form of cash, gold and unencumbered government securities. It is also known as the statutory liquidity Ratio (SLR). In those days, in India, the SLR was as high as 38.5 percent. According to the M. Narasimham's Committee it was one of the reasons for the poor profitability of banks. Similarly, the Cash Reserve Ratio (CRR) was as high as 15 percent. Taken together, banks needed to maintain 53.5 percent of their resources idle with the RBI.

Directed Credit Programme: Since nationalization the government has encouraged the lending to agriculture and small-scale industries at a confessional rate of interest. It is known as the directed credit programme. The committee opined that these sectors have matured and thus do not need such financial support. This directed credit programme was successful from the government’s point of view but it affected commercial banks in a bad manner. Basically it deteriorated the quality of loan, resulted in a shift from the security oriented loan to purpose oriented. Banks were given a huge target of priority sector lending, etc. ultimately leading to profit erosion of banks.

Interest Rate Structure: The committee found that the interest rate structure and rate of interest in India are highly regulated and controlled by the government. They also found that government used bank funds at a cheap rate under the SLR. At the same time the government advocated the philosophy of subsidized lending to certain sectors. The committee felt that there was no need for interest subsidy. It made banks handicapped in terms of building main strength and expanding credit supply.

Additional Suggestions: Committee also suggested that the determination of interest rate should be on grounds of market forces. It further suggested minimizing the slabs of interest.

Along with these major problem areas M. Narasimham's Committee also found various inconsistencies regarding the banking system in India. In order to remove them and make it more vibrant and efficient, it has given the following recommendations.

square Narasimham Committee Report I - 1991

The Narsimham Committee was set up in order to study the problems of the Indian financial system and to suggest some recommendations for improvement in the efficiency and productivity of the financial institution.

The committee has given the following major recommendations:

Reduction in the SLR and CRR: The committee recommended the reduction of the higher proportion of the Statutory Liquidity Ratio ‘SLR’ and the Cash Reserve Ratio ‘CRR’. Both of these ratios were very high at that time. The SLR then was 38.5% and CRR was 15%. This high amount of SLR and CRR meant locking the bank resources for government uses. It was hindrance in the productivity of the bank thus the committee recommended their gradual reduction. SLR was recommended to reduce from 38.5% to 25% and CRR from 15% to 3 to 5%.

Phasing out Directed Credit Programme: In India, since nationalization, directed credit programmes were adopted by the government. The committee recommended phasing out of this programme. This programme compelled banks to earmark then financial resources for the needy and poor sectors at confessional rates of interest. It was reducing the profitability of banks and thus the committee recommended the stopping of this programme.

Interest Rate Determination: The committee felt that the interest rates in India are regulated and controlled by the authorities. The determination of the interest rate should be on the grounds of market forces such as the demand for and the supply of fund. Hence the committee recommended eliminating government controls on interest rate and phasing out the concessional interest rates for the priority sector.

Structural Reorganizations of the Banking sector: The committee recommended that the actual numbers of public sector banks need to be reduced. Three to four big banks including SBI should be developed as
international banks. Eight to Ten Banks having nationwide presence should concentrate on the national and universal banking services. Local banks should concentrate on region specific banking. Regarding the RRBs (Regional Rural Banks), it recommended that they should focus on agriculture and rural financing. They recommended that the government should assure that henceforth there won't be any nationalization and private and foreign banks should be allowed liberal entry in India.

Establishment of the ARF Tribunal: The proportion of bad debts and Non-performing asset (NPA) of the public sector Banks and Development Financial Institute was very alarming in those days. The committee recommended the establishment of an Asset Reconstruction Fund (ARF). This fund will take over the proportion of the bad and doubtful debts from the banks and financial institutes. It would help banks to get rid of bad debts.

Removal of Dual control: Those days banks were under the dual control of the Reserve Bank of India (RBI) and the Banking Division of the Ministry of Finance (Government of India). The committee recommended the stepping of this system. It considered and recommended that the RBI should be the only main agency to regulate banking in India.

Banking Autonomy: The committee recommended that the public sector banks should be free and autonomous. In order to pursue competitiveness and efficiency, banks must enjoy autonomy so that they can reform the work culture and banking technology upgradation will thus be easy.

Some of these recommendations were later accepted by the Government of India and became banking reforms.

**SQUARE NARASIMHAM COMMITTEE REPORT II - 1998**

In 1998 the government appointed yet another committee under the chairmanship of Mr. Narsimham. It is better known as the Banking Sector Committee. It was told to review the banking reform progress and design a programme for further strengthening the financial system of India. The committee focused on various areas such as capital adequacy, bank mergers, bank legislation, etc.

It submitted its report to the Government in April 1998 with the following recommendations.

Strengthening Banks in India: The committee considered the stronger banking system in the context of the Current Account Convertibility 'CAC'. It thought that Indian banks must be capable of handling problems regarding domestic liquidity and exchange rate management in the light of CAC. Thus, it recommended the merger of strong banks which will have 'multiplier effect' on the industry.

Narrow Banking: Those days many public sector banks were facing a problem of the Non-performing assets (NPAs). Some of them had NPAs were as high as 20 percent of their assets. Thus for successful rehabilitation of these banks it recommended 'Narrow Banking Concept' where weak banks will be allowed to place their funds only in short term and risk free assets.

Capital Adequacy Ratio: In order to improve the inherent strength of the Indian banking system the committee recommended that the Government should raise the prescribed capital adequacy norms. This will further improve their absorption capacity also. Currently the capital adequacy ration for Indian banks is at 9 percent.

Bank ownership: As it had earlier mentioned the freedom for banks in its working and bank autonomy, it felt that the government control over the banks in the form of management and ownership and bank autonomy does not go hand in hand and thus it recommended a review of functions of boards and enabled them to adopt professional corporate strategy.

Review of banking laws: The committee considered that there was an urgent need for reviewing and amending main laws governing Indian Banking Industry like RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalisation Act, etc. This upgradation will bring them in line with the present needs of the banking sector in India.
Apart from these major recommendations, the committee has also recommended faster computerization, technology upgradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

EVALUATION OF NARSIMHAM COMMITTEE REPORTS

The Committee was first set up in 1991 under the chairmanship of Mr. M. Narasimham who was 13th governor of RBI. Only a few of its recommendations became banking reforms of India and others were not at all considered. Because of this a second committee was again set up in 1998.

As far as recommendations regarding bank restructuring, management freedom, strengthening the regulation are concerned, the RBI has to play a major role. If the major recommendations of this committee are accepted, it will prove to be fruitful in making Indian banks more profitable and efficient.

Non-Banking Financial Companies
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1Shares
NBFCs or Non Banking Financial Companies are those companies which provide banking services without meeting the legal definition of a bank. A NBFC is incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934.

The NBFCs do the business of loans and advances, acquisition of shares, stock, bonds, debentures, securities issued by Government. They also deal in other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business.

However, the companies cannot be NBFCs if their primary business is related to agriculture activity, industrial activity, sale/purchase/construction of immovable property.

Usually, the 50-50 test is used as an anchor to register an NBFC with RBI. 50-50 Test means that the companies at least 50% assets are financial assets and its income from financial assets is more than 50% of the gross income.

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• Difference between NBFC and Banks

Regulation of NBFCs
Non-Banking Financial Companies are regulated by different regulators in India such as RBI, Irda, SEBI, National Housing Bank and Department of Company Affairs. RBI regulates the companies which deal in lending, accepting deposits, financial leasing, hire purchase and acquisition of shares / stocks etc. The companies that take up activities like stock broking, merchant banking etc. are regulated by SEBI while the Nidhi and Chitfund companies are regulated by Department of Company Affairs. Housing finance companies are regulated by National Housing Bank.

NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI but they need to register with respective regulators. For example:
• Venture Capital Fund/Merchant Banking companies/Stock broking companies are registered with SEBI
• Insurance Company needs to hold a certificate of registration with IRDA
• Nidhi companies as notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982
• Housing Finance Companies regulated by National Housing Bank.

Difference between NBFC and Banks
The major differences between NBFCs and Banks are as follows:
• NBFC cannot accept demand deposits (they can accept term deposits)
• NBFCs do not form part of the payment and settlement system
• Non-Banking Financial Companies (NBFC) are establishments that provide financial services and banking facilities without meeting the legal definition of a Bank. They are covered under the Banking regulations laid down by the Reserve Bank of India and provide banking services like loans, credit facilities, TFCs, retirement planning, investing and stocking in money market. However they are restricted from taking any form of deposits from the general public. These organizations play a crucial role in the economy, offering their services in urban as well as rural areas, mostly granting loans allowing for growth of new ventures.

• NBFCs also provide a wide range of monetary advices like chit-reserves and advances. Hence it has become a very important part of our nation’s Gross Domestic Product and NBFCs alone count for 12.5% raise in Gross Domestic Product of our country. Most people prefer NBFCs over banks as they find them safe, efficient and quick in assisting with financial requirements. Moreover, there are various loan products available and there is flexibility and transparency in their services.

• There are a huge number of NBFCs operating in our country but here’s a look at the current top 10 NBFCs in India.

• Power Finance Corporation Limited
  • Finance Corporation Limited was founded in 1986 and is a Navratna Status company. Mukesh Kumar Goel is the Chairman & Managing Director of the company. Power Finance Corporation Limited is known to provide financial assistance to different power projects in the country. It supports organizations involved in Power generation, transmission and distribution. The company is also listed in National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

• Shriram Transport Finance Company Limited
  • Transport Finance Company Limited focuses on funding commercial and business vehicles, besides others. The company was founded in 1979 and has been offering funding services for Light Duty Trucks, Heavy Duty Trucks, Mini Trucks, Passenger Vehicles, Construction Vehicles and Farm Equipments. The company’s specialisation is in general insurance, mutual funds, common assets, stock broking and general protection.

• Bajaj Finance Limited
  • was founded in 2007 and is a unit of Bajaj Holdings and Investments. It offers loans to doctors for career enhancement, home loans, gold loans, individual Loans, business and entrepreneur loans and is an extremely popular finance company. Apart from these, Bajaj Finserv also provides services like wealth advisory, lending money and general insurance. It has over 1400 branches across the country with more than 20000 employees.

• Mahindra & Mahindra Financial Services Limited
  • Mahindra & Mahindra Financial Services Limited (MMFSL) was established in 1991 and has over 1000 branches, and a customer base of over 3 million, all over the country. MMFSL is one of the most renowned organizations and has two affiliates offering Insurance services and rural housing financial services. It also specialises in offering gold advances, vehicle advances, corporate advances, home credits, working capital advances and much more.

• Muthoot Finance Ltd
  • Muthoot Finance Ltd is India’s first NBFC tracing its history back to 1888, when it began as a small lender from a village in Kerala. Muthoot Finance Ltd sanctions loans only against pledge of gold ornaments. It is a leader in India’s gold loan and finance market. Besides financing gold transactions, Muthoot Finance Ltd offers foreign exchange services, money transfers, wealth management services, travel and tourism services. Gold coins are also sold at Muthoot Finance Branches. The company has its headquarters in Kerala, India, and operates over 4,400 branches throughout the country. It is also the parent company of Muthoot Housing Finance (India) Ltd, which offers home loans.

• HDB Finance Services
  • HDB Financial Services is operated by India’s largest private sector HDFC Bank. It offers a variety of secured and non-secured financial loans through a network of more than 1,000 branches in 22 Indian states and 3 Union Territories. It provides secured and unsecured loans, including personal and business loans, doctor's loans, auto loans, gold loans, new to credit loans, enterprise business loans, consumer durables
loans, construction equipment loans, new and used car loans, equipment loans, and tractor loans. The company operates through Lending Business and BPO Services segments. It is considered the fastest growing NBFC in India today.

Cholamandalam

Cholamandalam Investment and Finance Company Limited (Chola), was incorporated in 1978 as the financial services arm of the Murugappa Group. Chola started as an equipment financing company and has surged ahead as a complete financial services provider offering all kinds of services like vehicle finance, home loans, home equity loans, SME loans, investment advisory services, stock broking and a host of other financial services to customers. Chola has 725 branches across India with assets under management above INR 35,000 Crores.

Tata Capital Financial Services Ltd

Tata Capital Financial Services Limited is top of India’s leading NBFCs. Established in 2007, it is a subsidiary of Tata Sons Limited. TCFS describes itself as a one-stop financial service provider that caters to the diverse needs of retail, corporate and institutional customers across businesses. It is registered with RBI as ‘Systemically Important Non-Deposit Accepting Non-Banking Financial Company (NBFC)’. Among the various products offered by TCFS to individuals, families and businesses, are commercial finance, infrastructure finance, wealth management, consumer loans and distribution and marketing of Tata Cards.

L & T Finance Limited

L & T Finance Limited is a strong player in the non banking financial sector and was established in 1994. Headquartered in Mumbai, L & T offers funding services to different sectors like trade, industry, agriculture, Commercial Vehicle loans, Individual Vehicle loans, and corporate and rural loans. The company caters to more than 10 lakh people. In 2010, L & T was awarded the “Company of the year” in the Economic Times awards.

Aditya Birla Finance Ltd.

Aditya Birla Finance Limited, a part of the Aditya Birla Financial Services, was incorporated in 1991 and is an ISO 9001:2008 certified NBFC. ABFL is registered with RBI as a ‘systemically important non-deposit accepting NBFC’ and it ranks among the top five largest private diversified NBFCs in India. It offers precise and customised solutions across a wide range, from corpora

Non-Bank Financial Institution (NBFI)

Definition

The term non-bank financial institution refers to companies that offer financial services, but do not hold banking licenses and cannot accept deposits. Insurance companies, brokerage firms, and companies offering microloans are examples of non-bank financial institutions.

Explanation

A non-bank financial institution (NBFI) is an organization that provides financial services, but is not a licensed bank and is not allowed to accept deposits from customers. The types of services offered by a NBFI typically fall into the following categories:

- Risk Pooling Institutions: organizations such as insurance companies that spread financial risk among a large number of entities.
- Institutional Investors: organizations such as pension funds and mutual funds that trade securities in volumes that qualify for lower commissions.
- Other Non-Bank Financial Institutions: organizations that provide financial services such as leasing of assets, market makers (who provide liquidity), management companies, financial advisors, and securities brokers.

How to get NBFC License in India

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act that is engaged in the business of loans and advances, receiving deposits (some NBFC’s only), acquisition of stocks or shares, leasing, hire-purchase, insurance business, chit business. Therefore, NBFCs lend and take deposits similar to banks; however there are a few differences a) NBFC cannot accept demand deposits,
NBFCs cannot issue cheques drawn on itself and NBFC depositors are not covered by the Deposit Insurance and Credit Guarantee Corporation.

When is NBFC License with RBI Required?

The Reserve Bank of India regulates and supervises Non-Banking Financial Companies which are into the principal business of lending or acquisition of shares, stocks, bonds, etc., or financial leasing or hire purchase or accepting deposits. Principal business of financial activity is when a company’s financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 percent of the gross income. A company which fulfills both these criteria must have NBFC license. This test for NBFC license is popularly known as the 50-50 test.

Therefore, companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial activity in a small way, will not require NBFC registration.

Financial Companies NOT requiring NBFC License

The following types of entities that are involved in the principal business of financial activity do NOT require NBFC License:

- Housing Finance Companies – Regulated by the National Housing Bank;
- Insurance Companies – Regulated by Insurance Regulatory and Development Authority of India (IRDA);
- Stock Broking – Regulated by Securities and Exchange Board of India;
- Merchant Banking Companies – Regulated by Securities and Exchange Board of India;
- Venture Capital Companies – Regulated by Securities and Exchange Board of India;
- Companies that run Collective Investment Schemes – Regulated by Securities and Exchange Board of India;
- Mutual Funds – Regulated by Securities and Exchange Board of India;
- Nidhi Companies – Regulated by the Ministry of Corporate Affairs (MCA);
- Chit Fund Companies – Regulated by the respective State Governments.

The above types of companies have been exempted from NBFC registration requirements and NBFC regulations of RBI as they are regulated by other financial sector regulators.

Requirement for Obtaining NBFC License

To apply and obtain NBFC License, the following are the basic requirements:

- A Company Registered in India (Private Limited Company or Limited Company);
- The company must have minimum Net Owned Fund of Rs.200 lakhs.

Calculating Net Owned Funds as per RBI Definition

The Net Owned Funds would be calculated based on the last audited balance sheet of the Company. Net owned Fund will consist of paid up equity capital, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of assets but not reserves created by revaluation of assets. From the aggregate of items will be deducted accumulated loss balance and book value of intangible assets, if any, to arrive at owned funds. Further, investments in shares of other NBFCs and in shares, debentures of subsidiaries and group companies in excess of ten percent of the owned fund mentioned above will be deducted to arrive at the Net Owned Fund.

Types of NBFC License

Before applying for NBFC License, the type and category of NBFC license must first be determined. The following are the categories of NBFC Companies:

- Asset Finance Company (AFC): An Asset Finance Company is a company which is a financial institution carrying on as its principal business the financing of physical assets such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.
- Investment Company: An Investment Company is any company which is a financial institution carrying on as its principal business the acquisition of securities (shares / stocks / bonds / other financial securities).
Loan Company: Loan Company is any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

Infrastructure Finance Company: Infrastructure Finance Company is a non-banking finance company that deploys at least 75 per cent of its total assets in infrastructure loans, has a minimum Net Owned Funds of Rs. 300 crore, maintains a minimum credit rating of ‘A’ or equivalent with a Capital to Risk Assets Ratio of 15%.

Systemically Important Core Investment Company: Systemically Important Core Investment Company is an NBFC with an asset size of over Rs.100 crores and accepts deposits, involved in the business of acquisition of shares and securities which satisfies certain conditions.

Infrastructure Debt Fund: Infrastructure Debt Fund is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. Infrastructure Debt Funds raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity.

Non-Banking Financial Company – Micro Finance Institution (Most Popular): Micro Finance Institution is a non-deposit taking NBFC that is engaged in micro finance activities.

NBFC Factor: NBFC Factor is a non-deposit taking NBFC engaged in the principal business of factoring.

Applying for NBFC License

Applicant for NBFC License must be submitted online and offline with the necessary documents to the Regional Office of the Reserve Bank of India. The following are the documents that needs to be submitted for NBFC License:

• Information about the management
• Certified copies of Certificate of Incorporation and Certificate of Commencement of Business in case of public limited companies.
• Certified copies of up-to-date Memorandum and Articles of Association of the company. Details of clauses in the memorandum relating to financial business.
• Copy of PAN/CIN allotted to the company.
• Directors’ profile, separately filled up and signed by each director.
• Certificate from the respective NBFC/s where the Directors have gained NBFC experience.
• CIBIL Data pertaining to Directors of the company
• Financial Statements of the last 2 years of Unincorporated Bodies, if any, in the group where the directors may be holding directorship with/without substantial interest.
• Board Resolution specifically approving the submission of the application and its contents and authorising signatory.
• Board Resolution to the effect that the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India in writing.
• Board resolution stating that the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI.
• Certified copy of Board resolution for formulation of “Fair Practices Code”.
• Statutory Auditors Certificate certifying that the company is/does not accept/is not holding Public Deposit.
• Statutory Auditors Certificate certifying that the company is not carrying on any NBFC activity.
• Statutory Auditors Certificate certifying net owned fund as on date of the application.
• Details of Authorised Share Capital and latest shareholding pattern of the company including the percentages.
• Copy of Fixed Deposit receipt & bankers certificate of no lien indicating balances in support of Net Owned Funds.
• Details of the bank balances/bank accounts/complete postal address of the branch/bank, loan/credit facilities etc. availed.
• Last three years Audited balance sheet and Profit & Loss account along with directors & auditors report or for such shorter period as are available (for companies already in existence).
• Business plan of the company for the next three years giving details of its (a) thrust of business, (b) market segment and (c) projected balance sheets, cash flow statement, asset/income pattern statement without any element of public deposits.
• Source of the startup capital of the company substantiated with documentary evidence.
• Self attested Bank Statement/IT returns etc.

In addition to the above documents, more documents may be required as per the List of Document Required for NBFC License. You can also refer to the article on NBFC Registration and Regulations for more information about NBFC License in India.

NON BANKING FINANCIAL COMPANIES (NBFC)

Current Status: Prudential Norms

3. The Reserve Bank put in place in January 1998 a new regulatory framework involving prescription of prudential norms for NBFCs which are deposit taking to ensure that these NBFCs function on sound and healthy lines. Regulatory and supervisory attention was focused on the ‘deposit taking NBFCs’ (NBFCs – D) so as to enable the Reserve Bank to discharge its responsibilities to protect the interests of the depositors. NBFCs - D are subjected to certain bank –like prudential regulations on various aspects such as income recognition, asset classification and provisioning; capital adequacy; prudential exposure limits and accounting / disclosure requirements. However, the ‘non-deposit taking NBFCs’ (NBFCs – ND) are subject to minimal regulation.

4. The application of the prudential guidelines / limits, is thus not uniform across the banking and NBFC sectors and within the NBFC sector. There are distinct differences in the application of the prudential guidelines / norms as discussed below:

i) Banks are subject to income recognition, asset classification and provisioning norms; capital adequacy norms; single and group borrower limits; prudential limits on capital market exposures; classification and valuation norms for the investment portfolio; CRR / SLR requirements; accounting and disclosure norms and supervisory reporting requirements.

ii) NBFCs – D are subject to similar norms as banks except CRR requirements and prudential limits on capital market exposures. However, even where applicable, the norms apply at a rigour lesser than those applicable to banks. Certain restrictions apply to the investments by NBFCs – D in land and buildings and unquoted shares.

iii) Capital adequacy norms; CRR / SLR requirements; single and group borrower limits; prudential limits on capital market exposures; and the restrictions on investments in land and building and unquoted shares are not applicable to NBFCs – ND.

iv) Unsecured borrowing by companies is regulated by the Rules made under the Companies Act. Though NBFCs come under the purview of the Companies Act, they are exempted from the above Rules since they come under RBI regulation under the Reserve Bank of India Act. While in the case of NBFCs – D, their borrowing capacity is limited to a certain extent by the CRAR norm, there are no restrictions on the extent to which NBFCs – ND may leverage, even though they are in the financial services sector.

Current Status: Financial Linkages Between Banks and NBFC

5. Banks and NBFCs compete for some similar kinds of business on the asset side. NBFCs offer products/services which include leasing and hire-purchase, corporate loans, investment in non-convertible debentures, IPO funding, margin funding, small ticket loans, venture capital, etc. However NBFCs do not provide operating account facilities like savings and current deposits, cash credits, overdrafts etc.
6. NBFCs avail of bank finance for their operations as advances or by way of banks’ subscription to debentures and commercial paper issued by them.

7. Since both the banks and NBFCs are seen to be competing for increasingly similar types of some business, especially on the assets side, and since their regulatory and cost-incentive structures are not identical it is necessary to establish certain checks and balances to ensure that the banks’ depositors are not indirectly exposed to the risks of a different cost-incentive structure. Hence, following restrictions have been placed on the activities of NBFCs which banks may finance:

   i) Bills discounted / rediscounted by NBFCs, except for rediscounting of bills discounted by NBFCs arising from the sale of –

   a) commercial vehicles (including light commercial vehicles); and

   b) two-wheeler and three-wheeler vehicles, subject to certain conditions;

   i) Investments of NBFCs both of current and long term nature, in any company/entity by way of shares, debentures, etc. with certain exemptions;

   ii) Unsecured loans/inter-corporate deposits by NBFCs to/in any company.

   iii) All types of loans/advances by NBFCs to their subsidiaries, group companies/entities.

   iv) Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings (IPOs).

   v) Bridge loans of any nature, or interim finance against capital/debenture issues and/or in the form of loans of a bridging nature pending raising of long-term funds from the market by way of capital, deposits, etc. to all categories of Non-Banking Financial Companies, i.e. equipment leasing and hire-purchase finance companies, loan and investment companies, Residuary Non-Banking Companies (RNBCs).

   vi) Should not enter into lease agreements departmentally with equipment leasing companies as well as other Non-Banking Financial Companies engaged in equipment leasing.

Current Status : Structural Linkages Between Banks and NBFCs

8. Banks and NBFCs operating in the country are owned and established by entities in the private sector (both domestic and foreign), and the public sector. Some of the NBFCs are subsidiaries/ associates/ joint ventures of banks – including foreign banks, which may or may not have a physical operational presence in the country. There has been increasing interest in the recent past in setting up NBFCs in general and by banks, in particular.

9. Investment by a bank in a financial services company should not exceed 10 per cent of the bank’s paid-up share capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank’s paid-up share capital and reserves. Banks in India are required to obtain the prior approval of the concerned regulatory department of the Reserve Bank before being granted Certificate of Registration for establishing an NBFC and for making a strategic investment in an NBFC in India. However, foreign entities, including the head offices of foreign banks having branches in India may, under the automatic route for FDI, commence the business of NBFI after obtaining a Certificate of Registration from the Reserve Bank.
Regulatory Issues

10. NBFCs can undertake activities that are not permitted to be undertaken by banks or which the banks are permitted to undertake in a restricted manner, for example, financing of acquisitions and mergers, capital market activities, etc. The differences in the level of regulation of the banks and NBFCs, which are undertaking some similar activities, gives rise to considerable scope for regulatory arbitrage. Hence, routing of transactions through NBFCs would tantamount to undermining banking regulation. This is partially addressed in the case of NBFCs that are a part of banking group on account of prudential norms applicable for banking groups.

11. NBFCs - D may access public funds, either directly or indirectly through public deposits, CPs, debentures, inter-corporate deposits and bank finance and NBFCs – ND may access public funds through all of the above modes except through public deposits. The application of marginal regulation to NBFCs – ND that are large and systemically important and also have access to public funds can be a potential source of systemic risk through contagion even though these entities are not members of the payment and settlement systems.

12. At present, there are no prudential norms or guidelines on the intra-group transactions and exposures (ITEs) between the NBFCs and their parent entities. From the perspective of consolidated supervision of a banking group/ financial conglomerate, it is necessary to have some norms / limits on the ITEs to ensure that the activities of the banking group / financial conglomerate are undertaken in a prudent manner so that they would not be a threat to financial stability. Internationally, some regulators prescribe a ceiling on the level of transactions that a bank can have with its affiliates. These limits may operate either at a single entity level and / or at an aggregate level.

13. In terms of the provisions of the Banking Regulation Act, a bank is not allowed to set up a banking subsidiary. This eliminates the scope for more than one entity within a group competing for public deposits. However, this aspect is not well addressed under the existing framework where a bank operating in India may set up an NBFC – D as a subsidiary or where they have / acquire substantial holding in such an entity i.e., say more than 10 per cent.

14. Foreign direct investment in NBFCs is permitted under the automatic route in 19 specified activities subject to compliance with the minimum capitalization norms. Once an NBFC is established with the requisite capital under FEMA, subsequent diversification either through the existing company or through downstream NBFCs is undertaken without any further authorisation. This could give scope for undertaking those activities which do not qualify for FDI through the automatic route.

Underlying Principles for a Revised Framework

15. Thus the regulatory gaps in the area of bank and NBFC operations contribute to creating the possibility of regulatory arbitrage and hence giving rise to an uneven playing field and potential systemic risk. In this backdrop, the related issues have been examined and as recommended by the Group, a review of the existing framework of prudential regulations for bank and NBFC operations was undertaken. The broad principles underlying the review are as under.

i) Entities offering financial services should normally be within the ambit of financial regulations. However, all NBFCs – ND were largely excluded from the scope of financial regulation in view of the state of development of the financial sector at that time and as a matter of prioritisation of regulatory focus. In the light of the recent developments in the financial sector and its growth, as a first step, all systemically relevant entities offering financial services ought to be brought under a suitable regulatory framework to
contain systemic risk. The definition of what is considered systemically relevant will be as determined from time to time.

ii) The IMF publication, "Financial Sector Assessment - A Handbook" mentions that, "Similar risks and functions should be supervised similarly to minimize scope for regulatory arbitrage" and that, "Bank-like financial institutions should be supervised like banks." Similarly, the ‘Report of the Committee on Fuller Capital Account Convertibility’ has also identified that "modifications to regulation to discourage or eliminate scope for regulatory arbitrage, focusing on activity-centric regulation rather that institution-centric regulation will be needed" to enhance the strengthening of the banking system. Hence, the focus will be to reduce or eliminate the scope for regulatory arbitrage by ensuring that regulations are activity specific – irrespective of the medium through which the activity is undertaken.

iii) The ownership of NBFCs, which are subjected to a relatively less stringent regulatory and prudential framework, should be subjected to certain norms which will encourage improved governance so that regulatory arbitrage or circumvention of bank regulations are not resorted to. Further, the ownership pattern should be such that more than one entity in a Group does not compete for public deposits. Additionally, the principle of ‘holding out’ will operate in a situation where an NBFC is within a bank group. Hence, the eventual fall out of the holding out principle will have to be factored in while banks decide on the extent to which they would like to be involved in an NBFC.

iv) Consequent upon certain adverse events in the banking sector in the early 1990s, banks are not permitted to offer discretionary portfolio management scheme (PMS). As a corollary, the NBFCs sponsored by banks (viz. NBFCs which are subsidiaries of banks or where banks have a management control) are also not permitted to offer discretionary PMS. Whereas, other NBFCs are allowed to offer this product. Hence, ownership structure of the NBFC should not be determining factor to decide on the products that NBFCs may offer.

v) Foreign entities can undertake certain permitted activities in India under the automatic route for FDI. However, it might not be appropriate to allow a foreign entity to set up a presence through the automatic route and later expand into activities which are not permitted under the automatic route, without going through a further authorisation process.

vi) The overarching principle is that banks should not use an NBFC as a delivery vehicle for seeking regulatory arbitrage opportunities or to circumvent bank regulation(s) and that the activities of NBFCs do not undermine banking regulations. In case it is observed that any bank has not complied with the spirit of these guidelines, such non compliance should be viewed very strictly by the Reserve Bank.

Modifications to the Regulatory Framework

16. In the light of the concerns that arise out of the divergent regulatory requirements for various aspects of functioning of banks and NBFCs and keeping in view the broad principles for the proposed revision, the following modifications are being made in the regulatory framework for NBFCs.

A. Regulatory Framework for Systemically Important

NBFCs – ND (NBFC – ND – SI)

i) Determination of NBFC – ND – SI

All NBFCs – ND with an asset size of Rs. 100 crore and more as per the last audited balance sheet will be considered as a systemically important NBFC – ND.
ii) Capital Adequacy Ratio for NBFCs – ND – SI

NBFCs – ND – SI shall maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) of 10%. The present minimum CRAR stipulation at 12% or 15%, as the case may be, for NBFCs – D shall continue to be applicable.

iii) Single / Group Exposure norms for NBFCs – ND – SI

No NBFCs – ND – SI, as defined above, shall

a) lend to
   (i) any single borrower exceeding 15% of its owned fund; and
   (ii) any single group of borrowers exceeding 25% of its owned fund;

b) invest in
   (i) the shares of another company exceeding 15% of its owned fund; and
   (ii) the shares of a single group of companies exceeding 25% of its owned fund;

c) lend and invest (loans/investments taken together) exceeding
   (i) 25% of its owned fund to a single party; and
   (ii) 40% of its owned fund to a single group of parties.

- The above ceiling on the investment in shares of another company shall not be applicable to an NBFC in respect of investment in the equity capital of an insurance company up to the extent specifically permitted, in writing, by the Reserve Bank.


- Investments in debentures will be treated as lending and not investment.

- The above ceilings on credit / investments shall be applicable to the own group of the NBFC as well as to the other group of borrowers / investee companies.

- The NBFCs may exceed the concentration of credit/investment norms, as above, by 5 per cent for any single party and by 10 per cent for a single group of parties, if the additional exposure is on account of infrastructure loan and/or investment.

Further, the NBFCs – ND – SI are advised to have a policy in respect of exposures to a single entity / group. NBFCs-ND-SI not accessing public funds both directly and indirectly may apply to the Reserve Bank for an appropriate dispensation consistent with the spirit of the exposure limits.

B. Additional Single Exposure norms for Asset Finance Companies

i) In terms of circular DNBS.PD.CC.No.85/03.02.089/2006-2007 dated December 6, 2006, companies financing real/physical assets for productive /economic activity will be classified as Asset Finance Companies (AFCs) as per the criteria prescribed therein.
iv) In addition to the single party and single group of parties exposure norms prescribed for NBFCs-D and NBFCs-ND-SI, AFCs are permitted to exceed the exposure to a single party and single group of parties up to a further 5 percent of their owned fund in exceptional circumstances with the approval of their Boards.

C. Expansion of activities of NBFCs through automatic route

v) NBFCs set up under the automatic route will be permitted to undertake only those 19 activities which are permitted under the automatic route. Diversification into any other activity would require the prior approval of FIPB. Similarly a company which has entered into an area permitted under the FDI policy (such as software) and seeks to diversify into NBFC sector subsequently would also have to ensure compliance with the minimum capitalization norms and other regulations as applicable.

Effective date and transition

17. Taking into account the likelihood that some of the NBFCs may not be in compliance with some of the elements of the revised regulatory framework it has been decided to provide for a transition period up to end March 2007. Accordingly, NBFCs should comply with all elements of the revised framework with effect from April 1, 2007. In case any NBFC – ND – SI needs more time for compliance, it should apply to DNBS before the close of business on January 31, 2007 clearly indicating the reasons for which it is not able to ensure compliance within the above period and the time frame within which it would be able to comply with all the relevant elements. This will enable the Reserve Bank to take a view on the requests by end March 2007.

Scope of application to certain categories

18. The guidelines contained in this circular will be applicable to the NBFCs as specified in the relevant paragraphs except the categories mentioned below:

i) The Residuary Non Banking Companies (RNBCs) and Primary Dealers (PDs) are subject to a separate set of regulations. The Reserve Bank will constitute an Internal Group to review the existing guidelines applicable to these entities in the light of the guidelines contained in this circular and examine the need for prescribing supplementary guidelines which will be issued separately. Till then, these entities will continue to be governed by the existing regulations.

ii) Government owned companies, as defined under Section 617 of the Companies Act, which are registered with the Reserve Bank of India as NBFCs, are exempted from certain provisions of Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998, at present. It is proposed to bring all deposit taking and systemically important government owned companies under the provisions of the said Directions which will be in conformity with the existing guidelines, including those contained in this circular. However, the date from which they are to fully comply with the regulatory framework will be decided later. These companies are, therefore, required to prepare a roadmap for compliance with the various elements of the NBFC regulations, in consultation with the Government, and submit the same to the Reserve Bank (Department of Non Banking Supervision – (DNBS)), by March 31, 2007.

19. A separate circular has been issued to banks in this regard by the Department of Banking Operations and Development of Reserve Bank of India.

20. Please acknowledge receipt to the Regional Office of the Department of Non-Banking Supervision, Reserve Bank of India under whose jurisdiction the registered office of your company is situated.
All you wanted to know about NBFCs
(Updated as on January 10, 2017)
A. Definitions
1. What is a Non-Banking Financial Company (NBFC)?
A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956
engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities
issued by Government or local authority or other marketable securities of a like nature, leasing, hire-
purchase, insurance business, chit business but does not include any institution whose principal business is
that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or
providing any services and sale/purchase/construction of immovable property. A non-banking institution
which is a company and has principal business of receiving deposits under any scheme or arrangement in
one lump sum or in installments by way of contributions or in any other manner, is also a non-banking
financial company (Residuary non-banking company).
2. What does conducting financial activity as “principal business” mean?
Financial activity as principal business is when a company’s financial assets constitute more than 50 per
cent of the total assets and income from financial assets constitute more than 50 per cent of the gross
income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term
‘principal business’ is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as
to ensure that only companies predominantly engaged in financial activity get registered with it and are
regulated and supervised by it. Hence if there are companies engaged in agricultural operations, industrial
activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable
property as their principal business and are doing some financial business in a small way, they will not be
regulated by the Reserve Bank. Interestingly, this test is popularly known as 50-50 test and is applied to
determine whether or not a company is into financial business.
3. NBFCs are doing functions similar to banks. What is difference between banks & NBFCs?
NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a
few differences as given below:
i. NBFC cannot accept demand deposits;
ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on
itself;
iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to
depositors of NBFCs, unlike in case of banks.
4. Is it necessary that every NBFC should be registered with RBI?
In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or
carry on business of a non-banking financial institution without a) obtaining a certificate of registration
from the Bank and without having a Net Owned Funds of ₹ 25 lakhs (₹ Two crore since April 1999).
However, in terms of the powers given to the Bank, to obviate dual regulation, certain categories of
NBFCs which are regulated by other regulators are exempted from the requirement of registration with
RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with
SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as
notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of
Section 2 of the Chit Funds Act, 1982,Housing Finance Companies regulated by National Housing Bank,
Stock Exchange or a Mutual Benefit company.
5. What are the requirements for registration with RBI?
A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-
banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should comply with the
following:
i. it should be a company registered under Section 3 of the companies Act, 1956
ii. It should have a minimum net owned fund of ₹ 200 lakh. (The minimum net owned fund (NOF) required for specialized NBFCs like NBFC-MFIs, NBFC-Factors, CICs is indicated separately in the FAQs on specialized NBFCs)

6. What is the procedure for application to the Reserve Bank for Registration?
The applicant company is required to apply online and submit a physical copy of the application along with the necessary documents to the Regional Office of the Reserve Bank of India. The application can be submitted online by accessing RBI’s secured website https://cosmos.rbi.org.in. At this stage, the applicant company will not need to log on to the COSMOS application and hence user ids are not required. The company can click on “CLICK” for Company Registration on the login page of the COSMOS Application. A window showing the Excel application form available for download would be displayed. The company can then download suitable application form (i.e. NBFC or SC/RC) from the above website, key in the data and upload the application form. The company may note to indicate the correct name of the Regional Office in the field “C-8” of the “Annex-I identification Particulars” in the Excel application form. The company would then get a Company Application Reference Number for the CoR application filed on-line. Thereafter, the company has to submit the hard copy of the application form (indicating the online Company Application Reference Number, along with the supporting documents, to the concerned Regional Office. The company can then check the status of the application from the above mentioned secure address, by keying in the acknowledgement number.

7. What are the essential documents required to be submitted along with the application form to the Regional Office of the Reserve Bank?
The application form and an indicative checklist of the documents required to be submitted along with the application is available at www.rbi.org.in → Site Map → NBFC List → Forms/ Returns.

8. What are systemically important NBFCs?
NBFCs whose asset size is of ₹ 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

B. Entities Regulated by RBI and applicable regulations

9. Does the Reserve Bank regulate all financial companies?
No. Housing Finance Companies, Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking/sub-broking, Venture Capital Fund Companies, Nidhi Companies, Insurance companies and Chit Fund Companies are NBFCs but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions. Housing Finance Companies are regulated by National Housing Bank, Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by Insurance Regulatory and Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India. Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation.

It may also be mentioned that Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 If(f)(iii) of the RBI Act, 1934. Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

10. What are the different types/categories of NBFCs registered with RBI?
NBFCs are categorized a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs, b) non deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and c) by the kind of activity they conduct. Within this broad categorization the different types of NBFCs are as follows:

I. Asset Finance Company (AFC) : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments,
moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

II. Investment Company (IC): IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,

III. Loan Company (LC): LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

IV. Infrastructure Finance Company (IFC): IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of ₹ 300 crore, c) has a minimum credit rating of ‘A ’or equivalent d) and a CRAR of 15%.

V. Systemically Important Core Investment Company (CIC-ND-SI): CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

(a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;

(b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;

(c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.

(e) Its asset size is ₹ 100 crore or above

(f) It accepts public funds

VI. Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) : IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹ 1,00,000 or urban and semi-urban household income not exceeding ₹ 1,60,000;

b. loan amount does not exceed ₹ 50,000 in the first cycle and ₹ 1,00,000 in subsequent cycles;

c. total indebtedness of the borrower does not exceed ₹ 1,00,000;

d. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 15,000 with prepayment without penalty;

e. loan to be extended without collateral;

f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;

g. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower

VIII. Non-Banking Financial Company – Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

IX. Mortgage Guarantee Companies (MGC) - MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹ 100 crore.

X. NBFC- Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It’s a wholly-owned Non-Operative
Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

11. What are the powers of the Reserve Bank with regard to 'Non-Bank Financial Companies’, that is, companies that meet the 50-50 Principal Business Criteria?
The Reserve Bank has been given the powers under the RBI Act 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs that meet the 50-50 criteria of principal business. The Reserve Bank can penalize NBFCs for violating the provisions of the RBI Act or the directions or orders issued by RBI under RBI Act. The penal action can also result in RBI cancelling the Certificate of Registration issued to the NBFC, or prohibiting them from accepting deposits and alienating their assets or filing a winding up petition.

12. What action can be taken against persons/financial companies making false claim of being regulated by the Reserve Bank?
It is illegal for any financial entity or unincorporated body to make a false claim of being regulated by the Reserve Bank to mislead the public to collect deposits and is liable for penal action under the Indian Penal Code. Information in this regard may be forwarded to the nearest office of the Reserve Bank and the Police.

13. What action is taken if financial companies which are lending or making investments as their principal business do not obtain a Certificate of Registration from the Reserve Bank?
If companies that are required to be registered with the Reserve Bank as NBFCs, are found to be conducting non-banking financial activity, such as, lending, investment or deposit acceptance as their principal business, without seeking registration, the Reserve Bank can impose penalty or fine on them or can even prosecute them in a court of law. If members of public come across any entity which does non-banking financial activity but does not figure in the list of authorized NBFC on RBI website, they should inform the nearest Regional Office of the Reserve Bank, for appropriate action to be taken for contravention of the provisions of the RBI Act, 1934.

14. Where can one find list of Registered NBFCs and instructions issued to NBFCs?
The list of registered NBFCs is available on the web site of Reserve Bank of India and can be viewed at www.rbi.org.in → Sitemap → NBFC List. The instructions issued to NBFCs from time to time are also hosted at www.rbi.org.in → Notifications → Master Circulars → Non-banking, besides, being issued through Official Gazette notifications and press releases.

15. What are the regulations applicable on non-deposit accepting NBFCs with asset size of less than ₹ 500 crore?
The regulation on non-deposit accepting NBFCs with asset size of less than ₹ 500 crore would be as under:
(i) They shall not be subjected to any regulation either prudential or conduct of business regulations viz., Fair Practices Code (FPC), KYC, etc., if they have not accessed any public funds and do not have a customer interface.
(ii) Those having customer interface will be subjected only to conduct of business regulations including FPC, KYC etc., if they are not accessing public funds.
(iii) Those accepting public funds will be subjected to limited prudential regulations but not conduct of business regulations if they have no customer interface.
(iv) Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

16. What does the term public funds include? Is it the same as public deposits?
Public funds are not the same as public deposits. Public funds include public deposits, inter-corporate deposits, bank finance and all funds received whether directly or indirectly from outside sources such as funds raised by issue of Commercial Papers, debentures etc. However, even though public funds include public deposits in the general course, it may be noted that CICs/CICs-ND-SI cannot accept public deposits. Further, indirect receipt of public funds means funds received not directly but through associates and group entities which have access to public funds.

17. What are the various prudential regulations applicable to NBFCs?
The Bank has issued detailed directions on prudential norms, vide Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements. Details of the prudential regulations applicable to NBFCs holding deposits and those not holding deposits is available in the section ‘Regulation – Non-Banking – Notifications - Master Circulars’ in the RBI website.

18. Please explain the terms ‘owned fund’ and ‘net owned fund’ in relation to NBFCs?

‘Owned Fund’ means aggregate of the paid-up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, after deducting therefrom accumulated balance of loss, deferred revenue expenditure and other intangible assets. 'Net Owned Fund' is the amount as arrived at above, minus the amount of investments of such company in its subsidiaries, companies in the same group and all other NBFCs and the book value of debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group, to the extent it exceeds 10% of the owned fund.

19. What are the responsibilities of the NBFCs registered with Reserve Bank, with regard to submission on compliances and other information?

A. Returns to be submitted by deposit taking NBFCs
1. NBS-1 Quarterly Returns on deposits in First Schedule.
2. NBS-2 Quarterly return on Prudential Norms is required to be submitted by NBFC accepting public deposits.
3. NBS-3 Quarterly return on Liquid Assets by deposit taking NBFC.
4. NBS-4 Annual return of critical parameters by a rejected company holding public deposits. (NBS-5 stands withdrawn as submission of NBS 1 has been made quarterly.)
5. NBS-6 Monthly return on exposure to capital market by deposit taking NBFC with total assets of ₹ 100 crore and above.
6. Half-yearly ALM return by NBFC holding public deposits of more than ₹ 20 crore or asset size of more than ₹ 100 crore
8. Branch Info Return.
B. Returns to be submitted by NBFCs-ND-SI
9. NBS-7 A Quarterly statement of capital funds, risk weighted assets, risk asset ratio etc., for NBFC-ND-SI.
10. Monthly Return on Important Financial Parameters of NBFCs-ND-SI.
11. ALM returns:
(i) Statement of short term dynamic liquidity in format ALM [NBS-ALM1] -Monthly,
(ii) Statement of structural liquidity in format ALM [NBS-ALM2] Half yearly,
(iii) Statement of Interest Rate Sensitivity in format ALM-[NBS-ALM3], Half yearly
12. Branch Info return
C. Quarterly return on important financial parameters of non deposit taking NBFCs having assets of more than ₹ 50 crore and above but less than ₹ 100 crore

Basic information like name of the company, address, NOF, profit / loss during the last three years has to be submitted quarterly by non-deposit taking NBFCs with asset size between ₹ 50 crore and ₹ 100 crore.
There are other generic reports to be submitted by all NBFCs as elaborated in Master Circular on Returns to be submitted by NBFCs as available on www.rbi.org.in → Notifications → Master Circulars → Non-banking and Circular DNBS (IT) CC.No.02/24.01.191/2015-16 dated July 9, 2015 as available on www.rbi.org.in → Notifications.

20. Whether the circular on Lending against shares dated August 21, 2014 is applicable to existing loans also?

The Circular is applicable from the date of the circular and therefore the Circular shall not apply on those transactions which have been entered into prior to the date of the Circular. However, the guidelines will be applicable in case of roll-over/ renewal of loans. Guidelines will not apply to transactions where documents have been executed prior to the date of the circular and disbursement is pending.

21. Will the circular on Lending against shares be applicable on restructured accounts?

No, the Circular will not be applicable on restructured accounts.

22. Will the Circular on Lending against shares be applicable on those loans where the primary security is not shares/ units of mutual funds?

Loans which are against the collateral of multiple securities and it is specifically agreed to in the agreement that primary security would be something other than shares/ units of mutual funds, LTV would not be applicable. However, reporting requirements shall remain. In cases where such differentiation is not made (thereby NBFCs can off-load shares at the instance of a default), LTV would be applicable.

23. Whether LTV for loans issued against the collateral of shares is to be computed at script level or at portfolio level?

LTV would be computed at portfolio level.

24. Whether PoA/ Non-Disposal undertaking structure by whatever name called is covered under the Circular on Lending against shares?

Yes, the Circular would be applicable and the type of encumbrance created is immaterial.

25. Does the definition of “companies in a group” as given in Systemically Important Non-Banking Financial (non-deposit accepting or holding) companies Prudential Norms Directions, 2015 apply in respect of concentration of credit/ investment norms.

No, the definition of “companies is a group” is only for the purpose of determining the applicability of prudential norms on multiple NBFCs in a group.

26. Whether acquisition/ transfer of shareholding of 26 per cent or more of the paid up equity capital of an NBFC within the same group i.e. intra group transfers require prior approval of the Bank?

Yes, prior approval would be required in all cases of acquisition/ transfer of shareholding of 26 per cent or more of the paid up equity capital of an NBFC. In case of intra-group transfers, NBFCs shall submit an application, on the company letter head, for obtaining prior approval of the Bank. Based on the application of the NBFC, it would be decided, on a case to case basis, whether the NBFC requires to submit the documents as prescribed at para 3 of DNBR (PD) CC.No. 065/03.10.001/2015-16 dated July 9, 2015 for processing the application of the company. In cases where approval is granted without the documents, the NBFC would be required to submit the same after the process of transfer is complete.

27. NBFCs are charging high interest rates from their borrowers. Is there any ceiling on interest rate charged by the NBFCs to their borrowers?

Reserve Bank of India has deregulated interest rates to be charged to borrowers by financial institutions (other than NBFC- Micro Finance Institution). The rate of interest to be charged by the company is governed by the terms and conditions of the loan agreement entered into between the borrower and the NBFCs. However, the NBFCs have to be transparent and the rate of interest and manner of arriving at the rate of interest to different categories of borrowers should be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter etc.

28. RBI permits NBFCs to hedge their exposure through dealing in IRFs. Currently, IRFs are on single stock 10 yr 8.40% 2024 security. The Composition of Balance Sheet is mix of fixed/ floating interest rate and different credit profile. Whether 10 yr single security can be used for hedging 2-3 yr liability and asset (Duration adjusted) or can be used for investment in other long tenor securities or corporate bonds.
Alternatively, whether IRFs can be used holistically for hedging assets and liabilities in dynamic interest rate scenarios within total Balance Sheet amount and within hedging definition?

IRF may be used to hedge interest rate risk associated with single asset/liability or a group of assets/liabilities. Hence, NBFCs are permitted to use duration based hedging for managing interest rate risk.

29. Whether NBFCs as trading member can participate in the IRF market only for hedging or can also take trading position?

As per extant guidelines NBFCs with asset size of ₹1,000 cr and above are permitted to participate in IRF as trading members. While, trading members of stock exchanges are permitted to execute trades on their own account as well as on account of their clients, banks and PDs have been allowed to deal in IRF for both hedging and trading on own account and not on client’s account. Similarly, NBFCs as trading members are permitted to execute their proprietary trades and not to undertake transactions on behalf of clients.

C. Residuary Non-Banking Companies (RNBCs)

30. What is a Residuary Non-Banking Company (RNBC)? In what way it is different from other NBFCs?

Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets. The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions. Besides, Prudential Norms Directions are applicable to these companies also.

31. We understand that there is no ceiling on raising of deposits by RNBCs, then how safe is deposit with them?

It is true that there is no ceiling on raising of deposits by RNBCs. However, every RNBC has to ensure that the amounts deposited with it are fully invested in approved investments. In other words, in order to secure the interests of depositor, such companies are required to invest 100 per cent of their deposit liability into highly liquid and secure instruments, namely, Central/State Government securities, fixed deposits with scheduled commercial banks (SCB), Certificate of Deposits of SCB/FIs, units of Mutual Funds, etc.

32. Can RNBC forfeit deposit if deposit instalments are not paid regularly or discontinued?

No. Residuary Non-Banking Company cannot forfeit any amount deposited by the depositor, or any interest, premium, bonus or other advantage accrued thereon.

33. What is the rate of interest that an RNBC must pay on deposits and what should be maturity period of deposits taken by them?

The minimum interest an RNBC should pay on deposits should be 5% (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and 3.5% (to be compounded annually) on the amount deposited under daily deposit scheme. Interest here includes premium, bonus or any other advantage, that an RNBC promises to the depositor by way of return. An RNBC can accept deposits for a minimum period of 12 months and maximum period of 84 months from the date of receipt of such deposit. They cannot accept deposits repayable on demand. However, at present, the only RNBCs in existence (Peerless) has been directed by the Reserve Bank to stop collecting deposits, repay the deposits to the depositor and wind up their RNBC business as their business model is inherently unviable.

D. Definition of deposits, Eligible / Ineligible Institutions to accept deposits and Related Matters

34. What is ‘deposit’ and ‘public deposit’? Is it defined anywhere?

The term ‘deposit’ is defined under Section 45 I(bb) of the RBI Act, 1934. ‘Deposit’ includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form but does not include:

i. amount raised by way of share capital, or contributed as capital by partners of a firm;

ii. amount received from a scheduled bank, a co-operative bank, a banking company, Development bank, State Financial Corporation, IDBI or any other institution specified by RBI;
iii. amount received in ordinary course of business by way of security deposit, dealership deposit, earnest money, advance against orders for goods, properties or services;
iv. amount received by a registered money lender other than a body corporate;
v. amount received by way of subscriptions in respect of a ‘Chit’.

Paragraph 2(1)(xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 defines a ‘public deposit’ as a ‘deposit’ as defined under Section 45 I(bb) of the RBI Act, 1934 and further excludes the following:

a. amount received from the Central/ State Government or any other source where repayment is guaranteed by Central/ State Government or any amount received from local authority or foreign government or any foreign citizen/ authority/ person;
b. any amount received from financial institutions specified by RBI for this purpose;
c. any amount received by a company from any other company;
d. amount received by way of subscriptions to shares, stock, bonds or debentures pending allotment or by way of calls in advance if such amount is not repayable to the members under the articles of association of the company;
e. amount received from directors of a company or from its shareholders by private company or by a private company which has become a public company;
f. amount raised by issue of bonds or debentures secured by mortgage of any immovable property or other asset of the company subject to conditions;
fa. any amount raised by issuance of non-convertible debentures with a maturity more than one year and having the minimum subscription per investor at ₹ 1 crore and above, provided it is in accordance with the guidelines issued by the Bank.
g. the amount brought in by the promoters by way of unsecured loan;
h. amount received from a mutual fund;
i. any amount received as hybrid debt or subordinated debt;
j. amount received from a relative of the director of an NBFC;
k. any amount received by issuance of Commercial Paper.
l. any amount received by a systemically important non-deposit taking non-banking financial company by issuance of ‘perpetual debt instruments’
m. any amount raised by the issue of infrastructure bonds by an Infrastructure Finance Company

Thus, the directions exclude from the definition of public deposit, amount raised from certain set of informed lenders who can make independent decision.

35. Which entities can legally accept deposits from public?
Banks, including co-operative banks, can accept deposits. Non-bank finance companies, which have been issued Certificate of Registration by RBI with a specific licence to accept deposits, are entitled to accept public deposit. In other words, not all NBFCs registered with the Reserve Bank are entitled to accept deposits but only those that hold a deposit accepting Certificate of Registration can accept deposits. They can, however, accept deposits, only to the extent permissible. Housing Finance Companies, which are again specifically authorized to collect deposits and companies authorized by Ministry of Corporate Affairs under the Companies Acceptance of Deposits Rules framed by Central Government under the Companies Act can also accept deposits also up to a certain limit. Cooperative Credit Societies can accept deposits from their members but not from the general public. The Reserve Bank regulates the deposit acceptance only of banks, cooperative banks and NBFCs.

It is not legally permissible for other entities to accept public deposits. Unincorporated bodies like individuals, partnership firms, and other association of individuals are prohibited from carrying on the business of acceptance of deposits as their principal business. Such unincorporated bodies are prohibited from even accepting deposits if they are carrying on financial business.

36. Can all NBFCs accept deposits? Is there any ceiling on acceptance of Public Deposits? What is the rate of interest and period of deposit which NBFCs can accept?
All NBFCs are not entitled to accept public deposits. Only those NBFCs to which the Bank had given a specific authorisation and have an investment grade rating are allowed to accept/hold public deposits to a limit of 1.5 times of its Net Owned Funds. All existing unrated AFCs that have been allowed to accept deposits shall have to get themselves rated by March 31, 2016. Those AFCs that do not get an investment grade rating by March 31, 2016, will not be allowed to renew existing or accept fresh deposits thereafter. In the intervening period, i.e. till March 31, 2016, unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity, and not accept fresh deposits, till they obtain an investment grade rating.

However, as a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such has since 1997 not issued any Certificate of Registration (CoR) to new NBFCs for acceptance of public deposits.

Presently, the maximum rate of interest an NBFC can offer is 12.5%. The interest may be paid or compounded at rests not shorter than monthly rests. The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.

37. In respect of companies which do not fulfill the 50-50 criteria but are accepting deposits – do they come under RBI purview?
A company which does not have financial assets which is more than 50% of its total assets and does not derive at least 50% of its gross income from such assets is not an NBFC. Its principal business would be non-financial activity like agricultural operations, industrial activity, purchase or sale of goods or purchase/construction of immovable property, and will be a non-banking non-financial company. Acceptance of deposits by a Non-Banking Non-Financial Company are governed by the rules and regulations issued by the Ministry of Corporate Affairs.

38. Why is the RBI so restrictive in allowing NBFCs to raise public deposits?
The Reserve Bank’s overarching concern while supervising any financial entity is protection of depositors’ interest. Depositors place deposit with any entity on trust unlike an investor who invests in the shares of a company with the intention of sharing the risk as well as return with the promoters. Protection of depositors' interest thus is supreme in financial regulation. Banks are the most regulated financial entities. The Deposit Insurance and Credit Guarantee Corporation pays insurance on deposits up to ₹ One lakh in case a bank failed.

39. Which are the NBFCs specifically authorized by RBI to accept deposits?
The Reserve Bank publishes the list of NBFCs that hold a valid Certificate of Registration for accepting deposits on its website: www.rbi.org.in → Sitemap → NBFC List → List of NBFCs Permitted to Accept Deposits. At times, some companies are temporarily prohibited from accepting public deposits. The Reserve Bank publishes the list of NBFCs temporarily prohibited also on its website. The Reserve Bank keeps both these lists updated. Members of the public are advised to check both these lists before placing deposits with NBFCs.

40. Whether NBFCs can accept deposits from NRIs?
Effective from April 24, 2004, NBFCs cannot accept deposits from NRIs except deposits by debit to NRO account of NRI provided such amount does not represent inward remittance or transfer from NRE/FCNR (B) account. However, the existing NRI deposits can be renewed.

41. Can a Co-operative Credit Society accept deposits from the public?
No. Co-operative Credit Societies cannot accept deposits from general public. They can accept deposits only from their members within the limit specified in their bye laws.

42. Can a Salary Earners’ Society accept deposits from the public?
No. These societies are formed for salaried employees and hence they can accept deposit only from their own members and not from general public.

43. Is nomination facility available to the Depositors of NBFCs?
Yes, nomination facility is available to the depositors of NBFCs. The Rules for nomination facility are provided for in section 45QB of the Reserve Bank of India Act, 1934. Non-Banking Financial Companies have been advised to adopt the Banking Companies (Nomination) Rules, 1985 made under Section 45ZA.
of the Banking Regulation Act, 1949. Accordingly, depositor/s of NBFCs are permitted to nominate one person to whom the NBFC can return the deposit in the event of the death of the depositor/s. NBFCs are advised to accept nominations made by the depositors in the form similar to one specified under the said rules, viz Form DA 1 for the purpose of nomination, and Form DA2 and DA3 for cancellation of nomination and change of nomination respectively.

44. How does the Reserve Bank come to know about unauthorized acceptance of deposits by companies not registered with it or of NBFCs engaged in lending or investment activities without obtaining the Certificate of Registration from it?

NBFCs that ought to have sought registration from RBI but are functioning without doing so are committing a breach of law. Such companies are liable for action as envisaged under the RBI Act, 1934.

To identify such entities, RBI has multiple sources of information. These include market intelligence, complaints received from affected parties, industry sources, and exception reports submitted by statutory auditors in terms of Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 2008.

Further, the State Level Co-ordination Committees (SLCC) is convened by RBI in all the States/UTs on quarterly basis. The SLCC is now chaired by the Chief Secretary/ Administrator of the concerned State/UT and has, as its members, apart from the Reserve Bank, the Regional Directorate of the MCA/ ROC, local unit of SEBI, NHB, Registrar of Chits, ICAI, Economic Intelligence Unit of the State Police and officials from Law and Home Ministries of the State Government. As all the relevant financial sector regulators and enforcement agencies participate in the SLCC, it is possible to quickly share the information and agree on an effective course of action to be taken against entities indulging in unauthorized and suspect businesses involving funds mobilization from public.

45. Can Proprietorship/Partnership Concerns associated/not associated with registered NBFCs accept public deposits?

No. Proprietorship and partnership concerns are un-incorporated bodies. Hence they are prohibited under the RBI Act 1934 from accepting public deposits.

46. There are many jewellery shops taking money from the public in instalments. Is this amounting to acceptance of deposits?

It depends on whether the money is received as advance for delivering jewellery at a future date or whether the money is received with a promise to return the same with interest. The money accepted by Jewellery shops in instalments for the purpose of delivering jewellery at the end of the period of contract is not deposit. It will amount to acceptance of deposits if in return for the money received, the jewellery shop promises to return the principal amount along with interest.

47. What action can be taken if such unincorporated entities accept public deposits? What if NBFCs which have not been authorized to accept public deposits use proprietorship/partnership firms floated by their promoters to collect deposits?

Such unincorporated entities, if found accepting public deposits, are liable for criminal action. Further NBFCs are prohibited by RBI from associating with any unincorporated bodies. If NBFCs associate themselves with proprietorship/partnership firms accepting deposits in contravention of RBI Act, they are also liable to be prosecuted under criminal law or under the Protection of Interest of Depositors (in Financial Establishments) Act, if passed by the State Governments.

48. What is the difference between acceptance of money by Chit Funds and acceptance of deposits?

Deposits are defined under the RBI Act 1934 as acceptance of money other than that raised by way of share capital, money received from banks and other financial institutions, money received as security deposit, earnest money and advance against goods or services and subscriptions to chits. All other amounts, received as loan or in any form are treated as deposits. Chit Funds activity involves contributions by members in instalments by way of subscription to the Chit and by rotation each member of the Chit receives the chit amount. The subscriptions are specifically excluded from the definition of deposits and cannot be termed as deposits. While Chit funds may collect subscriptions as above, they are prohibited by RBI from accepting deposits with effect from August 2009.

E. Depositor Protection Issues
49. What are the salient features of NBFC regulations which the depositor may note at the time of investment?

Some of the important regulations relating to acceptance of deposits by NBFCs are as under:

i. The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.

ii. NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum. The interest may be paid or compounded at rests not shorter than monthly rests.

iii. NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.

iv. NBFCs should have minimum investment grade credit rating.

v. The deposits with NBFCs are not insured.

vi. The repayment of deposits by NBFCs is not guaranteed by RBI.

vii. Certain mandatory disclosures are to be made about the company in the Application Form issued by the company soliciting deposits.

50. What precautions should a depositor take before placing deposit with an NBFC?

A depositor wanting to place deposit with an NBFC must take the following precautions before placing deposits:

i. That the NBFC is registered with RBI and specifically authorized by the RBI to accept deposits. A list of deposit taking NBFCs entitled to accept deposits is available at www.rbi.org.in → Sitemap → NBFC List. The depositor should check the list of NBFCs permitted to accept public deposits and also check that it is not appearing in the list of companies prohibited from accepting deposits, which is available at www.rbi.org.in → Sitemap → NBFC List → NBFCs who have been issued prohibitory orders, winding up petitions filed and legal cases under Chapter IIIB, IIIC and others.

ii. NBFCs have to prominently display the Certificate of Registration (CoR) issued by the Reserve Bank on its site. This certificate should also reflect that the NBFC has been specifically authorized by RBI to accept deposits. Depositors must scrutinize the certificate to ensure that the NBFC is authorized to accept deposits.

iii. The maximum interest rate that an NBFC can pay to a depositor should not exceed 12.5%. The Reserve Bank keeps altering the interest rates depending on the macro-economic environment. The Reserve Bank publishes the change in the interest rates on www.rbi.org.in → Sitemap → NBFC List → FAQs.

iv. The depositor must insist on a proper receipt for every amount of deposit placed with the company. The receipt should be duly signed by an officer authorized by the company and should state the date of the deposit, the name of the depositor, the amount in words and figures, rate of interest payable, maturity date and amount.

v. In the case of brokers/agents etc collecting public deposits on behalf of NBFCs, the depositors should satisfy themselves that the brokers/agents are duly authorized by the NBFC.

vi. The depositor must bear in mind that public deposits are unsecured and Deposit Insurance facility is not available to depositors of NBFCs.

vii. The Reserve Bank of India does not accept any responsibility or guarantee about the present position as to the financial soundness of the company or for the correctness of any of the statements or representations made or opinions expressed by the company and for repayment of deposits/discharge of the liabilities by the company.

51. Does RBI guarantee the repayment of the deposits collected by NBFCs?

No. The Reserve Bank does not guarantee repayment of deposits by NBFCs even though they may be authorized to collect deposits. As such, investors and depositors should take informed decisions while placing deposit with an NBFC.

52. In case an NBFC defaults in repayment of deposit what course of action can be taken by depositors?

If an NBFC defaults in repayment of deposit, the depositor can approach Company Law Board or Consumer Forum or file a civil suit in a court of law to recover the deposits. NBFCs are also advised to follow a grievance redress procedure as indicated in reply to question 57 below. Further, at the level of the
State Government, the State Legislations on Protection of Interest of Depositors (in Financial Establishments) empowers the State Governments to take action even before the default takes place or complaints are received from depositors. If there is perpetration of an offence and if the intention is to defraud, the State Government can even attach properties.

53. What is the role of Company Law Board in protecting the interest of depositors? How can one approach it?
When an NBFC fails to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board (CLB) either on its own motion or on an application from the depositor, directs by order the Non-Banking Financial Company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order. After making the payment, the company will need to file the compliance with the local office of the Reserve Bank of India.

As explained above, the depositor can approach CLB by mailing an application in prescribed form to the appropriate bench of the Company Law Board according to its territorial jurisdiction along with the prescribed fee.

54. Can you give the addresses of the various benches of the Company Law Board (CLB) indicating their respective jurisdiction?
The details of addresses and territorial jurisdiction of the bench officers of CLB are as under:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Benches</th>
<th>Jurisdiction</th>
<th>Telephone No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Company Law Board Principal Bench</td>
<td>Paryavaran Bhawan, B-Block, 3rd Floor, C.G.O. Complex Lodhi Road, New Delhi – 110 003</td>
<td>011 – 24366126</td>
</tr>
<tr>
<td>3.</td>
<td>Company Law Board Kolkata Bench</td>
<td>5, Esplanade Row (West), Kolkata – 700 001, States of Arunachal Pradesh, Assam, Bihar, Manipur, Meghalaya, Nagaland, Orissa, Sikkim, Tripura, West Bengal, Jharkhand and Union Territories of Andaman and Nicobar Island and Mizoram. 033 – 22486330</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Company Law Board Mumbai Bench</td>
<td>N.T.C. House, 2ND Floor, 15 Narottam Morarjee Marg, Ballard Estate, Mumbai – 400 038, States of Goa, Gujarat, Madhya Pradesh, Maharashtra, Chhattisgarh and (Union Territories of Dadra and Nagar Haveli and Damman and Diu) 022 – 22619636</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Company Law Board Chennai Bench</td>
<td>Corporate Bhawan (UTI Building), 3rd Floor, No. 29 Rajaji Salari,</td>
<td></td>
</tr>
</tbody>
</table>
55. We hear that in a number of cases Official Liquidators have been appointed on the defaulting NBFCs. What is the procedure adopted by the Official Liquidator?

An Official Liquidator is appointed by the court after giving the company reasonable opportunity of being heard in a winding up petition. The liquidator performs the duties of winding up of the company and such duties in reference thereto as the court may impose. Where the court has appointed an official liquidator or provisional liquidator, he becomes custodian of the property of the company and runs day-to-day affairs of the company. He has to draw up a statement of affairs of the company in prescribed form containing particulars of assets of the company, its debts and liabilities, names/residences/occupations of its creditors, the debts due to the company and such other information as may be prescribed. The scheme is drawn up by the liquidator and same is put up to the court for approval. The liquidator realizes the assets of the company and arranges to repay the creditors according to the scheme approved by the court. The liquidator generally inserts advertisement in the newspaper inviting claims from depositors/investors in compliance with court orders. Therefore, the investors/depositors should file the claims within due time as per such notices of the liquidator. The Reserve Bank also provides assistance to the depositors in furnishing addresses of the official liquidator.

56. The Consumer Court plays useful role in attending to depositors problems. Can one approach Consumer Forum, Civil Court, CLB simultaneously?

Yes, a depositor can approach any or all of the redressal authorities i.e consumer forum, court or CLB.

57. Is there an Ombudsman for hearing complaints against NBFCs or Does RBI have any grievance redressal mechanism in place for NBFCs?

No, there is no Ombudsman for hearing complaints against NBFCs. However, in respect of credit card operations of an NBFC, which is a subsidiary of a bank, if a complainant does not get satisfactory response from the NBFC within a maximum period of thirty (30) days from the date of lodging the complaint, the customer will have the option to approach the Office of the concerned Banking Ombudsman for redressal of his grievance/s.

If complaints or grievances against the NBFCs are submitted to the nearest office of the Reserve Bank of India, the same are taken up with the NBFC concerned to facilitate resolution of the grievance/complaint. Further, all NBFCs have in place a Grievance Redressal Officer, whose name and contact details have to be mandatorily displayed in the premises of the NBFCs. The grievance can be taken up with the Grievance Redressal Officer. In case the complainant is not satisfied with the settlement of the complaint by the Grievance Redressal Officer of the NBFC, he/she may approach the nearest office of the Reserve Bank of India with the complaint. The details of the Office of the Reserve Bank has also to be mandatorily displayed in the premises of the NBFC.

58. Companies registered with MCA but not registered with RBI as NBFCs also sometimes default in repayment of deposit/ amounts invested with them? What is the recourse available to the investors in such an event? Does RBI have any role to play in such cases?

Companies registered with MCA but not required to be registered with RBI as NBFC are not under the regulatory domain of RBI. Whenever RBI receives any such complaints about the companies registered with MCA but not registered with RBI as NBFCs, it forwards the complaints to the Registrar of Companies (ROC) of the respective state for any action. The complainants are advised that the complaints relating to irregularities of such companies should be promptly lodged with ROC concerned for initiating corrective action. However, in case it comes to the knowledge of RBI those companies were required to be registered with the RBI, but have not done so and have accepted deposits as defined under RBI Act, such action as is deemed necessary under the provisions of the RBI Act will be taken.

59. The NBFCs have been made liable to pay interest on the overdue matured deposits if the company has not been able to repay the matured public deposits on receipt of a claim from the depositor. Please elaborate the provisions.

As per Reserve Bank’s Directions, overdue interest is payable to the depositors in case the company has delayed the repayment of matured deposits, and such interest is payable from the date of receipt of such
claim by the company or the date of maturity of the deposit whichever is later, till the date of actual payment. If the depositor has lodged his claim after the date of maturity, the company would be liable to pay interest for the period from the date of claim till the date of repayment. For the period between the date of maturity and the date of claim it is the discretion of the company to pay interest. In cases where NBFCs are required to freeze the term deposits of customer based on the orders of the enforcement authorities or the deposit receipts are seized by the enforcement authorities, they shall follow the procedure as given below:

i. Request letter may be obtained from the customer on maturity. While obtaining the request letter from the depositor for renewal, NBFCs should also advise him to indicate the term for which the deposit is to be renewed. In case the depositor does not exercise his option of choosing the term for renewal, NBFCs may renew the same for a term equal to the original term.

ii. No new receipt is required to be issued. However, suitable note may be made regarding renewal in the deposit ledger.

iii. Renewal of deposit may be advised by registered letter / speed post / courier service to the concerned Government department under advice to the depositor. In the advice to the depositor, the rate of interest at which the deposit is renewed should also be mentioned.

iv. If overdue period does not exceed 14 days on the date of receipt of the request letter, renewal may be done from the date of maturity. If it exceeds 14 days, NBFCs may pay interest for the overdue period as per the policy adopted by them, and keep it in a separate interest free sub-account which should be released when the original fixed deposit is released. However the final repayment of the principal and the interest so accrued should be done only after the clearance regarding the same is obtained by the NBFCs from the respective Government agencies.

60. Can a company pre-pay its public deposits?

An NBFC accepts deposits under a mutual contract with its depositors. In case a depositor requests for premature payment, Reserve Bank of India has prescribed Regulations for such an eventuality in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 wherein it is specified that NBFCs cannot grant any loan against a public deposit or make premature repayment of a public deposit within a period of three months (lock-in period) from the date of its acceptance. However, in the event of death of a depositor, the company may, even within the lock-in period, repay the deposit at the request of the joint holders with survivor clause / nominee / legal heir only against submission of relevant proof, to the satisfaction of the company.

An NBFC, (which is not a problem company) subject to above provisions, may permit after the lock-in period, premature repayment of a public deposit at its sole discretion, at the rate of interest prescribed by the Bank.

A problem NBFC is prohibited from making premature repayment of any deposits or granting any loan against public deposit/deposits, as the case may be. The prohibition shall not, however, apply in the case of death of depositor or repayment of tiny deposits i.e. up to ₹ 10000/- subject to lock in period of 3 months in the latter case.

61. What is the liquid assets requirement for the deposit taking companies? Where are these assets kept?

In terms of Section 45-IB of the RBI Act, 1934, the minimum level of liquid assets to be maintained by NBFCs is 15 per cent of public deposits outstanding as on the last working day of the second preceding quarter. Of the 15%, NBFCs are required to invest not less than ten percent in approved securities and the remaining 5% can be in unencumbered term deposits with any scheduled commercial bank. Thus, the liquid assets may consist of Government securities, Government guaranteed bonds and term deposits with any scheduled commercial bank.

The investment in Government securities should be in dematerialised form which can be maintained in Constituents’ Subsidiary General Ledger (CSGL) Account with a scheduled commercial bank (SCB) / Stock Holding Corporation of India Limited (SHICIL). In case of Government guaranteed bonds the same may be kept in dematerialised form with SCB/SHCIL or in a dematerialised account with depositories [National Securities Depository Ltd. (NSDL)/Central Depository Services (India) Ltd. (CDSL)] through a
depository participant registered with Securities & Exchange Board of India (SEBI). However in case there are Government bonds which are in physical form the same may be kept in safe custody of SCB/SHCIL.

NBFCs have been directed to maintain the mandated liquid asset securities in a dematerialised form with the entities stated above at a place where the registered office of the company is situated. However, if an NBFC intends to entrust the securities at a place other than the place at which its registered office is located, it may do so after obtaining the permission of RBI in writing. It may be noted that liquid assets in approved securities will have to be maintained in dematerialised form only. The liquid assets maintained as above are to be utilised for payment of claims of depositors. However, deposits being unsecured in nature, depositors do not have direct claim on liquid assets.

62. What does RBI do to protect the interest of NBFC depositors?
RBI has issued detailed regulations on deposit acceptance, including the quantum of deposits that can be collected, mandatory credit rating, mandatory maintenance of liquid assets for repayment to depositors, manner of maintenance of its deposit books, prudential regulations including maintenance of adequate capital, limitations on exposures, and inspection of the NBFCs, besides others, to ensure that the NBFCs function on sound lines. If the Bank observes through its inspection or audit of any NBFC or through complaints or through market intelligence, that a certain NBFC is not complying with RBI directions, it may prohibit the NBFC from accepting further deposits and prohibit it from selling its assets. In addition, if the depositor has complained to the Company Law Board (CLB) which has ordered repayment and the NBFC has not complied with the CLB order, RBI can initiate prosecution of the NBFC, including criminal action and winding up of the company.

More importantly, RBI initiates prompt action, including imposing penalties and taking legal action against companies which are found to be violating RBI's instructions/norms on basis of Market Intelligence reports, complaints, exception reports from statutory auditors of the companies, information received through SLCC meetings, etc. The Reserve Bank immediately shares such information with all the financial sector regulators and enforcement agencies in the State Level Coordination Committee Meetings. As a premier public policy institution, as part of its public policy measure, the Reserve Bank of India has been in the forefront in taking several initiatives to create awareness among the general public on the need to be careful while investing their hard earned money. The initiatives include issue of cautionary notices in print media and distribution of informative and educative brochures/pamphlets and close interaction with the public during awareness/outreach programs, Townhall events, participation in State Government sponsored trade fairs and exhibitions. At times, it even requests newspapers with large circulation (English and vernacular) to desist from accepting advertisements from unincorporated entities seeking deposits.

63. Who rates deposit taking NBFCs for acceptance of deposit?
NBFCs may get itself rated by any of the six rating agencies namely, CRISIL, CARE, ICRA, FITCH Ratings India Pvt. Ltd, Brickwork Ratings India Pvt. Ltd. and SMERA.

64. What are the symbols of minimum investment grade rating of different companies? When a company’s rating is downgraded, does it have to bring down its level of public deposits immediately or over a period of time?
The symbols of minimum investment grade rating of the Credit rating agencies are:

<table>
<thead>
<tr>
<th>Name of rating agencies</th>
<th>Nomenclature of minimum investment grade credit rating (MIGR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRISIL MA- (FA MINUS)</td>
<td>CARE BBB (FD)</td>
</tr>
<tr>
<td>ICRA MA- (MA MINUS)</td>
<td>FITCH Ratings India Pvt. Ltd.</td>
</tr>
<tr>
<td>CARE CARE BBB (FD)</td>
<td>SMERA tA-(ind)(FD)</td>
</tr>
<tr>
<td>Brickwork Ratings India Pvt. Ltd.</td>
<td>BWR FBBB</td>
</tr>
</tbody>
</table>

It may be added that A- is not equivalent to A, AA- is not equivalent to AA and AAA- is not equivalent to AAA.
However, if rating of an NBFC is downgraded to below minimum investment grade rating, it has to stop accepting public deposits, report the position within fifteen working days to the RBI and bring within three years from the date of such downgrading of credit rating, the amount of public deposit to nil. With the introduction of revised regulatory framework in November 2014 deposit taking NBFCs have to mandatorily get investment grade credit rating for being eligible to accept public deposits.

65. What is the purpose of enacting Protection of Interest of Depositors in Financial Establishments Act by the State Governments?

The purpose of enacting this law is to protect the interests of the depositors. The provisions of RBI Act are directed towards enabling RBI to issue prudential regulations that make the financial entities function on sound lines. RBI is a civil body and the RBI act is a civil Act. Both do not have specific provisions to effect recovery by attachment and sale of assets of the defaulting companies, entities or their officials. It is the State government machinery which can effectively do this. The Protection of Interest of Depositors in Financial Establishments Acts, confers adequate powers on the State Governments to attach and sell assets of the defaulting companies, entities and their officials.

66. Will the passage of the Protection of Interest of Depositors in Financial Establishments by the State Governments help in nailing unincorporated entities and companies from unauthorisedly accepting deposits?

Yes, to a large extent. The Act makes offences, such as, unauthorized acceptance of deposits by any entity, firm or company a cognizable offence, that is entities that are indulging in unauthorized deposit acceptance or unlawful financial activities can be immediately imprisoned and prosecuted. Under the Act, the State Governments have been given vast powers to attach the property of such entities, dispose them off under the orders of special courts and distribute the proceeds to the depositors. The widespread State Government / State Police machinery is best positioned to take quick action against the culprits. The Reserve Bank has, therefore, been urging all the State Governments to pass the legislation on Protection of Interest of Depositors in Financial Establishment Act.

67. Still there are cases of unscrupulous financial entities cheating public time and again. How does RBI plan to strengthen its surveillance on unauthorized acceptance of deposits/unauthorized conduct of NBFI business by companies?

The Reserve Bank is strengthening its market intelligence function in various Regional Offices and is constantly examining the financials of companies, references for which have been received through market intelligence or complaints to the Reserve Bank. In this, context, members of public can contribute a great deal by being vigilant and lodging a complaint immediately if they come across any financial entity that contravenes the RBI Act. For example, if they are accepting deposits unauthorisedly and/conducting NBFC activities without obtaining due permission from the RBI. More importantly, these entities will not be able to function if members of public start investing wisely. Members of the public must know that high returns on investments will also have high risks. And there can be no assured return for speculative activities. Before investing the public must ensure that the entity they are investing in is a regulated entity with one of the financial sector regulators.

F. Collective Investment Schemes (CIS) and Chit Funds

68. Are Collective Investment Schemes (CIS) regulated by the Reserve Bank of India?

No. CIS are schemes where money is exchanged for units, be it time share in resorts, profit from sale of wood or profits from the developed commercial plots and buildings and so on. Collective Investment Schemes (CIS) do not fall under the regulatory purview of the Reserve Bank.

69. Which is the authority that regulates Collective Investment Schemes (CIS)?

SEBI is the regulator of CIS. Information on such schemes and grievances against the promoters may be immediately forwarded to SEBI as well as to the EOW/Police Department of the State Government.

70. Is the conducting of Chit Fund business permissible under law?

The chit funds are governed by Chit Funds Act, 1982 which is a Central Act administered by state governments. Those chit funds which are registered under this Act can legally carry on chit fund business.

71. If Chit Fund companies are financial entities, why are they not regulated by RBI?
Chit Fund companies are regulated under the Chit Fund Act, 1982, which is a Central Act, and is implemented by the State Governments. RBI has prohibited chit fund companies from accepting deposits from the public in 2009. In case any Chit Fund is accepting public deposits, RBI can prosecute such chit funds.

G. Money Circulation/Multi-Level Marketing (MLM)/ Ponzi Schemes/ Unincorporated Bodies (UIBs)

72. There are some companies like Multi-Level Marketing companies, Direct Selling Companies, Online Selling Companies. Do they come under the purview of RBI?
No, Multi-Level Marketing companies, Direct Selling Companies, Online Selling Companies do not fall under the purview of RBI. Activities of these companies fall under the regulatory/administrative domain of respective state government. The list of regulators and the entities regulated by them are as provided in Annex I.

73. What are money circulation/Ponzi/multi-level marketing schemes?
Money circulation, multi level marketing / Chain Marketing or Ponzi schemes are schemes promising easy or quick money upon enrollment of members. Income under Multi level marketing or pyramid structured schemes do not come from the sale of products they offer as much as from enrolling more and more members from whom hefty subscription fees are taken. It is incumbent upon all members to enroll more members, as a portion of the subscription amounts so collected are distributed among the members at the top of the pyramid. Any break in the chain leads to the collapse of the pyramid, and the members lower in the pyramid are the ones that are affected the most. Ponzi schemes are those schemes that collect money from the public on promises of high returns. As there is no asset creation, money collected from one depositor is paid as returns to the other. Since there is no other activity generating returns, the scheme becomes unviable and impossible for the people running the scheme to meet the promised return or even return the principal amounts collected. The scheme inevitably fails and the perpetrators disappear with the money.

74. Is acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes allowed? Does RBI regulates such schemes?
No. Acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes and Ponzi schemes is not allowed as acceptance of money under those schemes is a cognizable offence under the Prize Chit and Money Circulation (Banning) Act 1978 and are hence banned. The Reserve Bank has no role in implementation of this Act, except advising and assisting the Central Government in framing the Rules under this Act.

75. Then who regulates entities that run such schemes?
Money Circulation/Multi-level Marketing /Pyramid structured schemes are an offence under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. The Act prohibits any person or individual to promote or conduct any prize chit or money circulation scheme or enrol as member to its schemes or anyone to participate in it by either receiving or remitting any money in pursuance of such chit or scheme. Contravention of the provisions of this Act, is monitored and dealt with by the State Governments.

76. What if someone operates such a scheme?
Any information/grievance relating to such schemes should be given to the police / Economic Offence Wing (EOW) of the concerned State Government or the Ministry of Corporate Affairs. If brought to RBI notice – we will inform the same to the concerned State Government authorities.

77. What are Unincorporated Bodies (UIBs)? Has RBI any role to play in curbing illegal deposit acceptance activities of UIBs? Who has the power to take action against Unincorporated Bodies (UIBs) accepting deposits?
Unincorporated bodies (UIBs) include an individual, a firm or an unincorporated association of individuals. In terms of provision of section 45S of RBI act, these entities are prohibited from accepting any deposit. The Act makes acceptance of deposits by such UIBs punishable with imprisonment or fine or both. The State government has to play a proactive role in arresting the illegal activities of such entities to protect interests of depositors/investors.
UIBs do not come under the regulatory domain of RBI. Whenever RBI receives any complaints against UIBs, it immediately forwards the same to the state government police agencies (Economic Offences
Wing (EOW)). The complainants are advised to lodge the complaints directly with the State government police authorities (EOW) so that appropriate action against the culprits is taken immediately and the process is hastened.

As per Section 45T of RBI Act, both the RBI and State Governments have been given concurrent powers. Nonetheless, in order to take immediate action against the offender, the information should immediately be passed on to the State Police or the Economic Offences Wing of the concerned State who can take prompt and appropriate action. Since the State Government machinery is widespread and the State Government is also empowered to take action under the provisions of RBI Act, 1934, any information on such entities accepting deposits may be provided immediately to the respective State Government’s Police Department/EOW.

Many of the State Governments have enacted the State Protection of Interests of Depositors in Financial Establishments Act, which empowers the State Government to take appropriate and timely action. RBI on its part has taken various steps to curb activities of UIBs which includes spreading awareness through advertisements in leading newspapers to sensitise public, organize various investors awareness programmes in various districts of the country, keeps close liaison with the law enforcing agencies (Economic Offences Wing).

78. There are some entities (not companies) which carry on activities like that of NBFCs. Are they allowed to take deposits? Who regulates them?

Any person who is an individual or a firm or unincorporated association of individuals cannot accept deposits except by way of loan from relatives, if his/its business wholly or partly includes loan, investment, hire-purchase or leasing activity or principal business is that of receiving of deposits under any scheme or arrangement or in any manner or lending in any manner.

79. What precautions have to be taken by the public to forewarn themselves about the likelihood of losing money in schemes that offer high rates of interest?

Before investing in schemes that promise high rates of return investors must ensure that the entity offering such returns is registered with one of the financial sector regulators and is authorized to accept funds, whether in the form of deposits or otherwise. Investors must generally be circumspect if the interest rates or rates of return on investments offered are high. Unless the entity accepting funds is able to earn more than what it promises, the entity will not be able to repay the investor as promised. For earning higher returns, the entity will have to take higher risks on the investments it makes. Higher the risk, the more speculative are its investments on which there can be no assured return. As such, the public should forewarn themselves that the likelihood of losing money in schemes that offer high rates of interest are more.

80. Who can the Depositor/Investor turn to in case of grievances?

The two Charts given at Annex I and II depict the activities and the regulators overseeing the same. Complaints may hence be addressed to the concerned regulator. If the activity is a banned activity, the aggrieved person can approach the State Police/Economic Offences Wing of the State Police and lodge a suitable complaint.

81. What constitutes Commercial Real Estate exposure?

An exposure to be classified as CRE, the essential feature would be that the funding will result in the creation/ acquisition of real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment would depends primarily on the cash flows generated by the asset. Additionally, the prospect of recovery in the event of default would also depend primarily on the cash flows generated from such funded asset which is taken as security, as would generally be the case. The primary source of cash flow (i.e. more than 50% of cash flows) for repayment would generally be lease or rental payments or the sale of the assets as also for recovery in the event of default where such asset is taken as security.

These guidelines will also be applicable to certain cases where the exposure may not be directly linked to the creation or acquisition of CRE but the repayment would come from the cash flows generated by CRE. For example, exposures taken against existing commercial real estate whose prospects of repayments primarily depend on rental/ sale proceeds of the real estate should be classified as CRE. Other such cases
may include: extension of guarantees on behalf of companies engaged in commercial real estate activities, exposures on account of derivative transactions undertaken with real estate companies, corporate loans extended to real estate companies and investment made in the equity and debt instruments of real estate companies.

Q 82. In terms of para 7.1 of the revised regulatory framework issued vide CC No. 002 dated November 10, 2014, total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the two categories viz., NBFCs-ND (those with assets of less than ₹ 500 crore) and NBFCs-ND-SI (those with assets of ₹ 500 crore and above). Regulations as applicable to the two categories will be applicable to each of the NBFC-ND within the group. Will this aggregation of assets apply to exempted category of CICs in the group?

No, the group requires to aggregate total assets of only those NBFCs which have been granted Certificate of Registration by the Bank. However, it must be ensured that the capital of the exempted category of CIC has not come, directly or indirectly, from an entity/ group company which has accessed public funds.

83. Whether LTV of 50% will also apply to lending against units of mutual funds?
Loans against units of mutual funds (except units of exclusively debt oriented mutual funds) would attract LTV requirements as are applicable to loans against shares. Further, the LTV requirement for loans/ advances against units of exclusively debt-oriented mutual funds may be decided by individual NBFCs in accordance with their loan policy.

84. Is prior written approval required in cases of merger of an NBFC ‘A’, with another NBFC/ entity ‘B’?
In this case prior written approval of the Reserve Bank is to be obtained by ‘A’. Where ‘B’ is an NBFC, as a result of merger if there is change in shareholding pattern of paid up equity capital of ‘B’ by 26% or more, prior written approval of the Reserve Bank is required. If ‘B’ is not an NBFC but is likely to meet PBC post-merger, it would also need to approach the Reserve Bank for prior written approval as well as registration as an NBFC.

85. Is prior written approval required in cases of merger of an entity (not an NBFC) with an NBFC?
Where a non-NBFC mergers with an NBFC, prior written approval of the Reserve Bank would be required if such a merger satisfies any one or both the conditions viz., (i) any change in the shareholding of the NBFC consequent on the merger which would result change in shareholding pattern of 26 per cent or more of the paid up equity capital of the NBFC (ii) any change in the management of the NBFC which would result in change in more than 30 per cent of the directors, excluding independent directors.

86. Is prior written approval required in cases of amalgamation of an NBFC ‘A’, with another NBFC/ entity ‘B’?
The NBFC/s being amalgamated will require to obtain prior written approval of the Reserve Bank.

87. Is prior written approval of the Reserve Bank required before approaching any Court or Tribunal for seeking orders for merger/ amalgamation?
Yes, prior approval of the Reserve Bank would have to be obtained before approaching any Court or Tribunal seeking orders for merger/ amalgamation in all such cases which would ordinarily fall under the scenarios explained in FAQs 84, 85 or 86.

88. Is the benefit of the direction relating to waiver of foreclosure charges/ prepayment penalty available to all categories of borrowers?
The benefit of the Directions contained in para 30(4) of Chapter VI of Master Direction - Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 and para 30(4) of Chapter V of Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 on waiver of foreclosure charges/ prepayment penalty is available only in respect of floating rate term loan availed by natural persons in their individual capacity, and not as proprietors or partners of a firm. Where the loan is availed jointly with a co-obligant(s) all persons who are party to the loan, whether as borrower(s) or co-obligant(s), shall be natural persons within their individual capacity and not as a proprietor/ partner of a firm.
**NBFC** is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement but does not include any institutions which carry on its principal business as agriculture activity, industrial activity, trading and purchase or sale of immovable properties. A company that carries on the business of accepting deposits as its principal business is also a NBFC.

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**ANNEX-II**

Introduction:

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money collected & invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debentures to money market instruments. The income earned through these investments and its unit holders in proportion to the number of units owned by them (pro rata) shares the capital appreciation realized by the scheme. Thus, a Mutual Fund is the most suitable investment for the common person as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost. Anybody with an investible surplus of as little as a few thousand rupees can invest in Mutual Funds. Each Mutual Fund scheme has a defined investment objective and strategy.

A mutual fund is the answer to all these situations. It appoints professionally qualified and experienced staff that manages each of these functions on a full time basis. The large pool of money collected in the fund allows it to hire such staff at a very low cost to each investor. In effect, the mutual fund vehicle exploits economies of scale in all three areas - research, investments and transaction processing. While the concept of individuals coming together to invest money collectively is not new, the mutual fund in its present form is a 20th century phenomenon. In fact, mutual funds gained popularity only after the Second World War. Globally, there are thousands of firms offering tens of thousands of mutual funds with different investment objectives. Today, mutual funds collectively manage almost as much as or more money as compared to banks.

**CONCEPT**

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them. Thus, a Mutual Fund is the most suitable investment for the common person as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. The flow chart below describes broadly the working of a mutual fund:

**THE SECURITY AND EXCHANGE BOARD OF INDIA (Mutual Funds) REGULATIONS,1996** defines a mutual fund as a " a fund establishment in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments."

Mutual Funds have been a significant source of investment in both government and corporate securities. It has been for the decades the monopoly of the state with UTI being the key player with invested funds exceeding Rs. 300 bn. (US $ 10 bn.). The state owned insurance companies also hold a portfolio of stocks. Presently, numerous mutual funds exist, including private and foreign companies. Banks - mainly state owned too have established Mutual Funds (MFs). Foreign participation in mutual funds and asset management companies permitted on a case-by-case basis.

Structure of the Indian mutual fund industry
The Indian mutual fund industry is dominated by the Unit Trust of India, which has a total corpus of Rs700bn collected from more than 20 million investors. The UTI has many funds/schemes in all categories i.e. equity, balanced, income etc with some being open-ended and some being closed-ended. The Unit Scheme 1964 commonly referred to as US 64, which is a balanced fund, is the biggest scheme with a corpus of about Rs200bn. Most of its investors believe that the UTI is government owned and controlled, which, while legally incorrect, is true for all practical purposes.

The second largest category of mutual funds is the ones floated by nationalized banks. Can bank Asset Management floated by Canara Bank and SBI Funds Management floated by the State Bank of India are the largest of these. GIC AMC floated by General Insurance Corporation and Jeevan Bima Sahayog AMC floated by the LIC are some of the other prominent ones.

Some of the AMCs operating currently are:

<table>
<thead>
<tr>
<th>Name of the AMC</th>
<th>Nature of ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alliance Capital Asset Management (I) Private Limited</td>
<td>Private foreign</td>
</tr>
<tr>
<td>Birla Sun Life Asset Management Company Limited</td>
<td>Private Indian</td>
</tr>
<tr>
<td>Bank of Baroda Asset Management Company Limited</td>
<td>Banks</td>
</tr>
<tr>
<td>Bank of India Asset Management Company Limited</td>
<td>Banks</td>
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<tr>
<td>Can bank Investment Management Services Limited</td>
<td>Banks</td>
</tr>
<tr>
<td>Cholamandalam Cazenove Asset Management Company Limited</td>
<td>Private foreign</td>
</tr>
<tr>
<td>Dundee Asset Management Company Limited</td>
<td>Private foreign</td>
</tr>
<tr>
<td>DSP Merrill Lynch Asset Management Company Limited</td>
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<td>Unit Trust of India</td>
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<td>Zurich Asset Management Company (I)</td>
<td>Limited Private foreign</td>
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Recent trends in mutual fund industry

The most important trend in the mutual fund industry is the aggressive expansion of the foreign owned mutual fund companies and the decline of the companies floated by nationalized banks and smaller private sector players.

Many nationalized banks got into the mutual fund business in the early nineties and got off to a good start due to the stock market boom prevailing then. These banks did not really understand the mutual fund business and they just viewed it as another kind of banking activity. Few hired specialized staff and
generally chose to transfer staff from the parent organizations. The performance of most of the schemes floated by these funds was not good. Some schemes had offered guaranteed returns and their parent organizations had to bail out these AMCs by paying large amounts of money as the difference between the guaranteed and actual returns. The service levels were also very bad. Most of these AMCs have not been able to retain staff, float new schemes etc. and it is doubtful whether, barring a few exceptions, they have serious plans of continuing the activity in a major way.

The experience of some of the AMCs floated by private sector Indian companies was also very similar. They quickly realized that the AMC business is a business, which makes money in the long term and requires deep-pocketed support in the intermediate years. Some have sold out to foreign owned companies, some have merged with others and there is general restructuring going on. They can be credited with introducing many new practices such as new product innovation, sharp improvement in service standards and disclosure, usage of technology, broker education and support etc. In fact, they have forced the industry to upgrade itself and service levels of organizations like UTI have improved dramatically in the last few years in response to the competition provided by these.

Performance of Mutual Funds in India

Let us start the discussion of the performance of mutual funds in India from the day the concept of mutual fund took birth in India. The year was 1963. Unit Trust of India invited investors or rather to those who believed in savings, to park their money in UTI Mutual Fund. The performance of mutual funds in India in the initial phase was not even closer to satisfactory level. People rarely understood, and of course investing was out of question. But yes, some 24 million shareholders were accustomed with guaranteed high returns by the beginning of liberalization of the industry in 1992. This good record of UTI became marketing tool for new entrants. The expectations of investors touched the sky in profitability factor. However, people were miles away from the preparedness of risks factor after the liberalization.

The Assets under Management of UTI was Rs. 67bn. by the end of 1987. Let me concentrate about the performance of mutual funds in India through figures. From Rs. 67bn. the Assets Under Management rose to Rs. 470 bn. in March 1993 and the figure had a three times higher performance by April 2004. It rose as high as Rs. 1,540bn. The net asset value (NAV) of mutual funds in India declined when stock prices started falling in the year 1992. Those days, the market regulations did not allow portfolio shifts into alternative investments. There was rather no choice apart from holding the cash or to further continue investing in shares. One more thing to be noted, since only closed-end funds were floated in the market, the investors disinvested by selling at a loss in the secondary market.

The performance of mutual funds in India suffered qualitatively. The 1992 stock market scandal, the losses by disinvestments and of course the lack of transparent rules in the whereabouts rocked confidence among the investors. Partly owing to a relatively weak stock market performance, mutual funds have not yet recovered, with funds trading at an average discount of 1020 percent of their net asset value. The measure was taken to make mutual funds the key instrument for long-term saving. The more the variety offered, the quantitative will be investors. At last to mention, as long as mutual fund companies are performing with lower risks and higher profitability within a short span of time, more and more people will be inclined to invest until and unless they are fully educated with the dos and don'ts of mutual funds.

Market Trends

COMPARISION OF MUTUAL FUNDS WITH OTHER INSTRUMENT

A lone UTI with just one scheme in 1964 now competes with as many as 400 odd products and 34 players in the market. In spite of the stiff competition and losing market share, Last six years have been the most turbulent as well as exiting ones for the industry. New players have come in, while others have decided to close shop by either selling off or merging with others. Product innovation is now passé with the game shifting to performance delivery in fund management as well as service. Those directly associated with the fund management industry like distributors, registrars and transfer agents, and even the regulators have become more mature and responsible.
The industry is also having a profound impact on financial markets. While UTI has always been a dominant player on the bourses as well as the debt markets, the new generations of private funds, which have gained substantial mass, are now flexing their muscles. Fund managers, by their selection criteria for stocks have forced corporate governance on the industry. Rewarding honest and transparent management with higher valuations has created a system of risk-reward created where the corporate sector is more transparent then before.

Funds have shifted their focus to the recession free sectors like pharmaceuticals, FMCG and technology sector. Funds performances are improving. Funds collection, which averaged at less than Rs100bn per annum over five-year period spanning 1993-98 doubled to Rs210bn in 1998-99. In the current year mobilization till now have exceeded Rs300bn. Total collection for the current financial year ending March 2000 is expected to reach Rs450bn.

What is particularly noteworthy is that bulk of the mobilization has been by the private sector mutual funds rather than public sector mutual funds. Indeed private MFs saw a net inflow of Rs. 7819.34 Crore during the first nine months of the year as against a net inflow of Rs.604.40 Crore in the case of public sector funds.

MUTUAL FUNDS ADVANTAGES:
The benefits on offer are many with good post-tax returns and reasonable safety being the hallmark that we normally associate with them. Some of the other major benefits of investing in them are:
Number of available options
Mutual funds invest according to the underlying investment objective as specified at the time of launching a scheme. So, we have equity funds, debt funds, gilt funds and many others that cater to the different needs of the investor. The availability of these options makes them a good option. While equity funds can be as risky as the stock markets themselves, debt funds offer the kind of security that aimed at the time of making investments. Money market funds offer the liquidity that desired by big investors who wish to park surplus funds for very short-term periods. The only pertinent factor here is that the fund has to selected keeping the risk profile of the investor in mind because the products listed above have different risks associated with them. So, while equity funds are a good bet for a long term, they may not find favor with corporate or High Net worth Individuals (HNIs) who have short-term needs.

Diversification
Investments spread across a wide cross-section of industries and sectors and so the risk is reduced. Diversification reduces the risk because not all stocks move in the same direction at the same time. One can achieve this diversification through a Mutual Fund with far less money than one can on his own.

Professional Management
Mutual Funds employ the services of skilled professionals who have years of experience to back them up. They use intensive research techniques to analyze each investment option for the potential of returns along with their risk levels to come up with the figures for performance that determine the suitability of any potential investment.

Potential of Returns
Returns in the mutual funds are generally better than any other option in any other avenue over a reasonable period. People can pick their investment horizon and stay put in the chosen fund for the duration. Equity funds can outperform most other investments over long periods by placing long-term calls on fundamentally good stocks. The debt funds too will outperform other options such as banks. Though they are affected by the interest rate risk in general, the returns generated are more as they pick securities with different duration that have different yields and so are able to increase the overall returns from the

Get Focused
I will admit that investing in individual stocks can be fun because each company has a unique story. However, it is important for people to focus on making money. Investing is not a game. Your financial future depends on where you put you hard-earned dollars and it should not take lightly.

Efficiency
By pooling investors' monies together, mutual fund companies can take advantage of economies of scale. With large sums of money to invest, they often trade commission-free and have personal contacts at the brokerage firms.

Ease of Use
Can you imagine keeping track of a portfolio consisting of hundreds of stocks? The bookkeeping duties involved with stocks are much more complicated than owning a mutual fund. If you are doing your own taxes, or are short on time, this can be a big deal.

Wealthy stock investors get special treatment from brokers and wealthy bank account holders get special treatment from the banks, but mutual funds are non-discriminatory. It doesn't matter whether you have $50 or $500,000, you are getting the exact same manager, the same account access and the same investment.

Risk
In general, mutual funds carry much lower risk than stocks. This is primarily due to diversification (as mentioned above). Certain mutual funds can be riskier than individual stocks, but you have to go out of your way to find them.

With stocks, one worry is that the company you are investing in goes bankrupt. With mutual funds, that chance is next to nil. Since mutual funds, typically hold anywhere from 25-5000 companies, all of the companies that it holds would have to go bankrupt.

I will not argue that you should not ever invest in individual stocks, but I do hope you see the advantages of using mutual funds and make the right choice for the money that you really care about.

Drawbacks of Mutual Funds
Mutual funds have their drawbacks and may not be for everyone:

No Guarantees: No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

Fees and commissions: All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if you don't use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.

Taxes: During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.

Management risk: When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers.

Regulatory Aspects
Schemes of a Mutual Fund
The asset management company shall launch no scheme unless the trustees approve such scheme and a copy of the offer document has filed with the Board.

Every mutual fund shall along with the offer document of each scheme pay filing fees.

The offer document shall contain disclosures, which are adequate in order to enable the investors to make informed investment decision including the disclosure on maximum investments proposed to make by the scheme in the listed securities of the group companies of the sponsor a close-ended scheme shall fully redeemed at the end of the maturity period. "Unless a majority of the unit holders otherwise decide for its rollover by passing a resolution".

The mutual fund and asset management company shall be liable to refund the application money to the applicants,-

(i) If the mutual fund fails to receive the minimum subscription amount referred to in clause (a) of sub-regulation (1);
(ii) If the moneys received from the applicants for units are in excess of subscription as referred to in clause (b) of sub-regulation (1).

Rules Regarding Advertisement:
The offer document and advertisement materials shall not be misleading or contain any statement or opinion, which are incorrect or false.

General Obligations:
The financial year for all the schemes shall end as of March 31 of each year. Every mutual fund or the asset management company shall prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule.

Every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.

Restrictions on Investments:
A mutual fund scheme shall not invest more than 15% of its NAV in debt instruments issued by a single issuer, which are rated not below investment grade by a credit rating agency authorized to carry out such activity under the Act. Such investment limit may be extended to 20% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of asset Management Company.

Conclusion:
Mutual funds are funds that pool the money of several investors to invest in equity or debt markets. Mutual Funds could be Equity funds, Debt funds or balanced funds.

Fund are selected on quantitative parameters like volatility, FAMA Model, risk adjusted returns, and rolling return coupled with a qualitative analysis of fund performance and investment styles through regular interactions / due diligence processes with fund managers.

MF History
The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases

First Phase - 1964-1987
Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs. 6,700 crores of assets under management.

Second Phase - 1987-1993 (Entry of Public Sector Funds)
1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990.

At the end of 1993, the mutual fund industry had assets under management of Rs. 47,004 crores.

Third Phase - 1993-2003 (Entry of Private Sector Funds)
With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003,
there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs. 44,541 crores of assets under management was way ahead of other mutual funds.

Fourth Phase - since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs. 76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

The graph indicates the growth of assets over the years.

Note:
Erstwhile UTI was bifurcated into UTI Mutual Fund and the Specified Undertaking of the Unit Trust of India effective from February 2003. The Assets under management of the Specified Undertaking of the Unit Trust of India has therefore been excluded from the total assets of the industry as a whole from February 2003 onwards.

Insurance Companies in India - Life & General Insurance Companies

Insurance sector has shown tremendous growth in the recent years. In the future as well, it is expected to progress at a high scale. Earlier, only two Insurance companies were there in India – Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). Now, this sector has 24 Life Insurance and 24 General Insurance companies which offer various innovative products keeping in mind the different needs of people. Most of these companies have entered the market in collaboration with International firms.

These companies have come up with a bundle of policies which have their own pros and cons. Every investor has his/her own needs, risk appetite, future goals and budget. As per these factors, a plan useless for one can be the best for another.

We are providing you with the list of General & Life Insurance companies based on their policy fees, overall expert ratings, complaint ratings, financial strength, credit ratings and more such factors. You can also understand the products of these companies by going through the Product Reviews, Articles and other details that we have provided.

fe Insurance Companies Brief Details

There are currently, a total of 24 life insurance companies in India. Of these, Life Insurance Corporation of India (LIC) is the only public sector insurance company. All others are private insurance companies. Many of these are joint ventures between public/private sector banks and national/international insurance-financial companies.

Private life insurance companies in India got access to the life insurance sector in the year 2000. Most private players have tied up with international insurance giants for their life insurance foray.

AEGON Life Insurance Company

AEGON Life Insurance is a joint venture between one of the world’s leading financial service organization and Bennett, Coleman & Company. The company is focused to provide a customer centric business along with an excellent and innovative working professionals. Started its operation in year 2008 the company works with a multiple channel distribution strategy with an aim to help people to plan their life in a much better way. The company has launched an array of products that focuses on offering best suited plans to the customers to meet their financial goal. The plans offered by the company are term plan, endowment plan, Group plan, ULIP plan, pension plan, protection plan, saving plan, child plan and ruler plan.
Aviva Life Insurance Company
Aviva Life Insurance is the largest and the most popular insurance provider in the world. The company is a joint venture between the Dabur Group and Aviva Group. With 121 networked centers across the country, Aviva Life Insurance serves a large number of customer base country wise. Among the other insurance companies in India, the company is known to first introduce Unit Link and Unitized With-Profit Plan in the market. The Aviva Life Insurance Company offers a wide variety of plans to the customers. These plans fulfill all the needs and necessities of the buyers at a very economical price. Some of the most common plans offered by the company are protection plan, ruler plan, child plan, retirement plan, saving plan, health plan, term plan and group insurance plan.

Bajaj Allianz Life Insurance Company
Bajaj Allianz Life Insurance is a joint venture between the European financial services company Allianz SE and Bajaj Finserv Limited. The company has gained name as one of the top most life insurance brand in India. Among the other life insurance companies in India, Bajaj Allianz Life Insurance Company meet its customers need by providing them a huge range of products right from ULIP and Child Plan to Group and Health Insurance. The company provide a huge array of customized products that cater the every single demand of the customer and provide them a transparent benefit. Launched in year 2001, this life insurance company provides a one-stop solution to the customers and help them in achieving their financial goals.

Bharti AXA Life Insurance Company
Headquartered in Mumbai, Bharti AXA Life Insurance is a life and general insurance provider company. The company is a joint venture between Bharti Enterprises and AXA Group. The customers can choose from the wide range of policies offered by the company ranging from investment plans to traditional plan or life insurance plan to child plan. The company is flourishing immensely and has a network of 123 offices in different cities across India. The customers have witnessed a maximum grievances resolved by the company in a year and had experienced a claim settlement ratio of 80.00%. The policies offered by the company has a maximum tenure of 65 years and the age criteria for the plans starts from minimum 18 years to maximum 65 years.

Birla Sun Life Insurance Company
With a 2.5 million of customer base, the Birla Sun Life Insurance is one of the leading insurance company in India. Birla Sun Life Insurance came into existence with the joint venture between Aditya Birla Group and Sun Life Financial Inc. The company is known as a pioneer of Unit Linked Life Insurance plans and has over 600 branches spread over 500 cities across the country. A complete range of insurance services is offered by Birla Sun Life Insurance like protection plan, child plan, health and retirement solution, ULIP plan, customized group product and life stage product to provide compete satisfaction to the customers. With a claim settlement ratio of 88.45% the company offers the best plans for the customers.

Canara HSBC OBC Life Insurance Company
Launched on year 2008, Canara HSBC OBC Life Insurance is a joint venture between HSBC Insurance Holding Ltd, Canara Bank and Oriental Bank. The company works as a pan India network with around 7000 branches of the three shareholder banks across the country. Moreover, the company provides necessary training and coaching to the bank staff across the 28 centers in country. With a huge customer base the company provides most customized products to meet the needs of the buyers. The policies offered by the company has a maximum tenure of 40 years and the eligibility criteria ranges from minimum 18 years – maximum 70 years.

DHFL Pramerica Life Insurance Company
Situated in Gurgaon, DHFL Pramerica Life Insurance is considered to be India’s premier Life Insurance Providers. The company serves with 67 branches and 2000 employees spread across the country. Although despite of being a new company the firm is growing by heaps and bounds and had made a remarkable place in the market. The company offers a variety of plans to the customers within a maximum tenure of 30 years. The company has a claim settlement ratio of 84.00% from year 2015-2016 and is ranked for maximum grievances settled over the year. DHFL Pramerica Life Insurance have a huge customer base and provide one stop solution for all insurance needs.
Edelweiss Tokio Life Insurance Company
Edelweiss Tokio Life Insurance established in 2011 is a newly formed private sector insurance provider in India. Edelweiss Group of India and Tokyo Marine Holding of Japan joined hands together and has formed Edelweiss Tokio Life Insurance Company. The company offers a host of life insurance products to the customer with high returns and guaranteed interest payment. Some of the most common plans offered by the company are saving plans, endowment plans, child plans, protection plans and retirement plans. Above this to fulfill the requirements of the customer the company also provide add-on coverages like accidental death benefit rider, accidental total and permanent disability rider and critical illness rider.

Exide Life Insurance Company
Found in year 2000 the Exide Life Insurance Company started its operation in 2001. The company was formerly known as ING Vysya Life Insurance Company Ltd. and is 100% owned by Exide industries Ltd. Exide Life Insurance has a network of 200 offices across the country and is supported by over 35,000 advisors. The company is ranked as top 10 Trusted Life Insurance Brand in India. As compared to the other insurance companies in India the plan offered by the company is customized in a way to fulfill the requirements of the customer and is available at very affordable rates. With a customer centric approach the plans are categorized into protection, saving, investment and retirement plan. For all your insurance needs the Exide Life Insurance offers a one stop solution to the customers.

Future Generali India Life Insurance Company
Established in year 2007, Future Generali Life Insurance India is a joint venture between Generali Group, Future Group and Industrial Investment Trust Limited. The company has a network of 98 branches over India and since its inception it has sourced over 11 Lakh policies. The company offers one stop solution for all types of financial security to the customer and serves their products on different areas like saving protection, policies and Unit Linked Policies. The policies are offered with a maximum tenure up to 75 years and the eligibility criteria ranges from least 18 years to maximum 56 years. The company has a record of maximum grievances settled and provide a claim ratio of 90.61%.

HDFC Standard Life Insurance Company
HDFC Standard Life Insurance Corporation India is a joint venture between Housing Development Financial Corporation Ltd. and Standard Life Plus. Founded in year 2000 HDFC Standard Life insurance is one of the leading insurance firm in India. The company has currently 27 retail and 8 group products in portfolio. In order to meet the various needs of the customer the company provides an array of individual and group insurance solutions like pension plan, saving and health plan, protection plan, child plan and women plan. With over 414 branches spread in 900 cities and towns in India the company has a claim settlement ratio of 95.02%. HDFC Life Insurance Company offers plans in a much customized way to fulfill the requirements of the customer.

ICICI Prudential Life Insurance Company
ICICI Prudential Life Insurance Corporation of India is a joint venture between ICICI Bank Ltd.; one of the India’s leading private sector bank and Prudential Plus; one of the largest international financial service group. The company began its operation in December 2000 as the first private sector Life insurance in India. For over a decade the company has maintained its top most position amongst the private life insurer in country. To fulfill the different life stage requirements of the customer, ICICI Prudential Life Insurance provides an array of products that enables the buyers to achieve the long term goal. ICICI Prudential life insurance offers products like term plan, ULIP plan, Pension Plan, Child Plan and Investment Plan.

IDBI Federal Life Insurance Company
Formed in 2008 IDBI Federal Life Insurance is a joint venture between IDBI Bank, Federal Bank and Ageas a European Insurance Company. With a partnered network of 2137 branches over the country the company offers a wide range of capital management solution, protection and retirement to the corporate customers as well as individual. The bank also offers ingenious technological solution to its customers. To be eligible for IDBI Federal Life Insurance one should have a minimum age limit of 18 years to maximum age limit of 55 years. The company has a record of maximum grievances over a short period of time and provide a claim settlement ratio of 84.79% for a year.

IndiaFirst Life Insurance Company
The two Indian public sector bank, Bank of Baroda and Andhra Bank went into a joint venture with U.K based investment firm Legal and General and has launched India First Life Insurance Company. Headquartered in Mumbai the company offers investment funds, insurance plans and other policies. The company offers a wide range of plans to cater the need of every individual like saving plans, protection plans, pension plans, term plans and child plans. With a network branches of 4,800 across the country the company serves over 1000 cities in India and offers a claim settlement ration of 72.21% over a year. India First Life Insurance Company Ltd not only fulfills all the needs of the customer additionally the plans offered to the customer is also very economical.

Kotak Mahindra Life Insurance Company
Headquartered in Mumbai the J.V between Kotak Mahindra Group and Old Mutual Fund is Kotak Mahindra Life Insurance. It is one of the fastest growing insurance company in India that has a 4 million trusted policyholder nationwide. Keeping their customers in high priority the company provides a much affordable range of term plan, ULIP plan, child plan, saving plan, investment plan, protection plan and retirement plan. The company has much gained name in the market for delivering outstanding value to its customer through customized products and excellent service. The Kotak Mahindra Life Insurance provide plans with a maximum tenure of 30 years and eligibility criteria with minimum 18 years to maximum 65 years.

Life Insurance Corporation (LIC) India Company
Life Insurance Corporation of India is the oldest insurance sector of our country. Established in 1956, one of the largest insurance company of India is a state owned insurance group and investment firm that offers a range of insurance products to its customers. Some of the common products that is offered by the company are life insurance plans, pension plans, child insurance plans, unit linked plans, special plans and group scheme. With a network of 2,048 branches the company has a huge number of employees operating in different cities and town all over the country. LIC has a claim settlement ratio of 98.19% with maximum grievances settled over year.

Max Life Insurance Company
Max Financial Service Ltd. and Mitsui Sumitomo Insurance Co.Ltd joined hands together and has launched Max Life Insurance as one of the foremost insurance company in India. With multi-channel distribution partner and high service providing agencies the company offers the most comprehensive long term protection, saving and retirement schemes. With a strong customer centric approach the company offers one stop solution for all types of insurance and investment needs. Max Life Insurance has a strong track record of 15 years and offers superb investment expertise. With a claim settlement ratio of 96.23% the company has a maximum grievances resolved over a year.

PNB MetLife Insurance Company
An association of Punjab National Bank PNB MetLife Insurance is one of the fastest growing life insurance company in India. The company has over 1,800 corporate clients in India and is spread over 150 different location in country. The company is well known for its protection and retirement products. Apart from this there are various plans like child plan, saving plan, ULIP plan, Monthly income plan and money back plan that is offered to the customer. PNB MetLife Insurance Company in India came into action in year 2008 and was recognized as best private sector insurance company for the year 2013-2014. For the insurance products offered by the company the eligibility criteria starts from minimum 18 years – maximum 65 years old.

Reliance Life Insurance Company
One of the India’s largest life insurance firm Reliance Life Insurance is a part of Reliance capital of the Reliance Group. The company has over 10 million policyholder country wise with a network close to 1,230 branches across the country. The company is currently the largest non-bank supported private life insurer in India. Reliance Life Insurance has claim settlement ration of approximately 95.01% and have a record of maximum grievances resolved over a year. The company mainly target products to individuals along with the group sand corporate entities. The company offers some of the most comprehensive plans like retirement, children, protection, investment and health plan. The maximum tenure of the policies are 35 years and the eligibility criteria to avail the criteria starts from minimum 18 years – maximum 55 years.
Sahara Life Insurance Company
Established in 2004, Sahara Life Insurance is India’s first wholly owned private life insurance company. With acknowledgeable presence in most part of the country the company serves almost all the sections of the society right from ruler to middle class and urban based. With a customer centric approach the Sahara Life Insurance Provides an extensive range of products like money back plan, unit link plan, term assurance plan, endowment plan and group assurance plan to cater the insurance needs of every individual. The company has a claim settlement ration of 89.97% and has resolved the maximum number of grievances for the customer over the year.

SBI Life Insurance Company
Introduced in year 2001, SBI Life Insurance Company is a Joint venture between State Bank of India and BNP Paribas Cardif. Holding a share of 6.12% of the total market currently the company is the biggest private sector insurance company in India. SBI Life Insurance Company offers an inclusive range of life insurance and pension products at a very economical rate. With a claim settlement ratio of 95.70% the customers have testify the most number of grievances resolved by this company. As one of the top most insurance company in India it offers variant plans like saving plan, unit link plan, protection plan, child plan and pension plan to cater the need of an individuals.

Shriram Life Insurance Company
Shriram Life Insurance was established in year 2005, by a joint venture between Shriram Group and Sanlam Group. The company has a network of 630 branches across the different countries in India and caters the diverse needs of the customers from the different cities of the country. The company take pride for efficient usage of capital and low operation cost. The major key features of the company is that it focuses on ruler market and serve the more economically weaker section of the society. With a variety of plans offered by the company the maximum tenure of the policy ranges up to 25 years and the eligibility criteria ranges from minimum 18 years to maximum 65 years.

Star Union Dai-Ichi Life Insurance Company
The Bank of India, Union Bank of India and the largest life insurance company of Japan Dai-Ichi Life entered into joint venture and has launched Star Union Dai-Ichi Life Insurance Co.Ltd. As one of the paramount insurance solution provider in country the company provides a wide range of insurance products to the customers. Star Union Dai-Ichi Life Insurance cater a large number of customers and clients across the country from numerous economic and social background. The company pledge a long term commitment towards their buyers and have earned trust over long years. As a customer centric company this leading insurance company India offers various products like saving plan, wealth plan, protection plan, child plan, pension plan, credit life plan and term plan.

TATA AIA Life Insurance Company
TATA Sons and the AIA Group teamed up to form a joint venture and has launched TATA AIA life Insurance Company. In this venture the majority of stake i.e. 75% is held by TATA Sons and 26 % by AIA Group of company. The company works with a customer centric approach and offers an extensive range of Insurance Product to people, association and corporate insurance buyers. Started working in year 2001 the company provides various plan in multiple segments like group plan, child plan, wealth plan, protection plan, saving plan and micro insurance plan. Among the numerous insurance companies in India, TATA AIA Life Insurance has made a remarkable position in the insurance sector of the country.

General Insurance Companies in India
General Insurance or non life-insurance provides insurance of property against fire, burglary, etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. Errors and Omissions insurance for professionals, credit insurance, etc., are also covered in the policy. The various types of General insurance policies are as below:
1. Motor Insurance: The policy provides a complete and cost-effective two-wheeler, commercial vehicles as well as private car insurance plans with the optimum coverage.
2. Health Insurance: Health insurance policy is an insurance scheme that provides its customer with financial cover against medical cost for any individual or family.
3. Travel Insurance: Travel insurance policy has been designed for the people to provide a financial support in case of loss of luggage, passport or any other belongings while travelling.

4. Home Insurance: This insurance policy covers various personal insurance and protections such losses to home and its content liability insurance for accidents.

Introduction

Insurance Regulatory and Development Authority of India Act was passed by the Parliament in the year December 1999. The Act received President’s approval in the year January 2000. The Act intents to protect the interest of the insurance policy holders. It also aims to encourage and ensure the systematic growth of the insurance industry. The Insurance Regulatory and Development Authority is a statutory body formed by the Insurance Regulatory and Development Authority of India Act, 1999.

What do we mean by Insurance?

Insurance is a monetary instrument, which reduces the financial burden in the events of eventualities, and provides a financial safety. A certain type of loss can be covered by paying a small premium. In case of loss, the Insurance Company will pay a certain amount of money, which will help in reducing the financial burden.

Insurance Products

There are a variety of Insurance products to cater to the different needs of different people. The customer has a lot of options to choose from depending on their needs. The customer is nowadays in place to analyze and compare the policies of various companies with one another and choose the best amongst them. The insurance industry has a large market to target. The Insurance products act more as a protection tool than as a way to save tax. As there is more demand from the customer for new, beneficial and improved insurance products, there is a healthy competition amongst the insurers. This acts as a boon to the customer. Improved products along with attractive schemes have been designed by the public sector to give tough competition to the private sector.

The market is full of different kinds of insurance products. Price, service and products are the main factors that differentiate one product from another. No Company can introduce a new product before taking a prior approval from Insurance Regulatory and Development Authority.

Insurance Regulatory and Development Authority of India

Composition of the Authority

The Authority Comprises of the following members mentioned below:-

1. The Authority comprises of chairman, whole time members and part time members and together they act as a group of members and work jointly not individually like Controller of Insurance.
2. The Authority will continue to work even in cases of death or resignation.
3. The Authority is a body corporate with perpetual succession and a common seal.
4. The Authority has the power to sue or can be sued in its own name.

Powers & Functions of the Authority

Section 14 of the Insurance Regulatory and Development Authority of India Act, 1999 states the powers and functions of the IRDA. The power and functions of the Authority are as follows:

1. The Authority aims to protect the interest of the insurance policyholders in the matters related to surrender value of the policy, settlement of insurance claims, insurable interest, nomination by policy holders etc.
2. The authority gives the Certificate of Registration to the applicant. It can also renew, modify, withdraw, suspend or even cancel the registration of the applicant
3. The Authority states the qualifications, code of conduct and practical training for the intermediaries and insurance agents.
4. The Authority promotes the efficiency in the conduct of the business of insurance.
5. The Authority states the code of conduct for surveyors and loss assessors.
6. The Authority promotes and controls the professional organizations that are connected with the insurance business. It levies fees and charges for carrying the purpose of this Act.
7. The Authority has the power to call for information, conduct investigation, audit and enquiry of the insurers, insurance intermediaries and organization connected with the business of insurance.
8. The Authority controls and regulate the rates, gains terms and conditions that are offered by the insurers with respect to the general insurance business.
9. The investment of funds by the insurance companies are regulated by the Authority.
10. The Authority regulates the margin of solvency.
11. The Authority provides dispute resolution between the insurers and insurance intermediaries.
12. The Authority controls the working of Tariff Advisory Committee.
13. The Authority lay down the percentage of premium income of the insurer to fund the schemes for promoting and controlling the professional organizations.
14. The Authority lay down the percentage of life insurance and general insurance business that can be carried out by the insurer in the rural or social sector.

Role of Insurance Regulatory and Development Authority (IRDA)

1. To protect the interest of and ensure just treatment to insurance policy holders.
2. To encourage and ensure the systematic growth of the insurance industry so as to benefit the common man and help in bringing economic growth.
3. To set, promote, monitor and apply high standards of integrity, fair dealing, financial viability and capability of those it regulates.
4. To ensure clarity, preciseness, transparency while dealing with the insurance policy holder. The Authority ensure that correct information about the products and services is passed on to the policy holders along with making them aware of their responsibilities.
5. To provide dispute resolution mechanism and ensure speedy settlement of genuine claims. The Authority must check insurance scams and other misconducts.
6. To take suitable steps against circumstances where set standards do not prevail or inappropriately enforced.
7. To bring about the optimal amount of self-regulation in day-to-day activities of the industry reliable with the requirements of the prudential regulation.

Effect of Insurance Regulatory and Development Authority (IRDA)

Effect on Regulation of Insurance Industry
Insurance Regulatory and Development Authority regulates the Insurance sector. It aims to protect the interest of the insurance policy holders. It also encourages and ensure the systematic growth of the insurance industry.

Effect over protection of policyholders
IRDA has great impact over the protection of policyholders. The Authority aims to provide fair treatment to all the policyholders.

Effect over Awareness about Insurance
IRDA is taking steps to increase awareness amongst the masses about the benefits of insurance. There is a separate Consumer education website of IRDA to educate people about insurance.

Effect over Insurance Market
There is a drastic effect of Insurance Regulatory and Development Authority over insurance market. IRDA regulates the insurance market and ensure the systematic and speedy growth of the insurance market.

Effect over Development of Insurance Product
All the insurance companies must take approval from Insurance Regulatory and Development Authority before launching any new product or before making any changes in the existing product or withdrawing a product. The insurers who wishes to launch a new product or make changes to the existing product or withdrawing a product shall submit an application to the Authority in the prescribed form along with the necessary details and reasons for the change reasons. The authority may ask for additional information if required. If no information is asked for then the insurer can start selling the product. The insurer can introduces the new product after allowing it for 60 days for non-life and 30 days for life for clearance by IRDA. This might be delayed due to lack of details about the product, which is necessary to assess the product before approval is given by the Authority.

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Effect on Competition between Private and Public sector
As there is more demand from the customer for new, beneficial and improved insurance products, there is a healthy competition amongst the insurers. This acts as a boon to the customer. Improved products along with attractive schemes has been designed by the public sector to give tough competition to the private sector.

Effect over Banks and Post Offices
With the increasing awareness amongst people about the benefits of insurance, the flow of funds have shifted to the insurance industry from Banks and Post Offices. Insurance has become a medium for not only covering losses and risks but has also become a popular way to save tax.

Bhopal Gas tragedy – Importance of Insurance
A Story of Industrial Disaster vis-à-vis Insurance Protection
In 1970, Union Carbide India Ltd (UCIL) established a pesticide manufacturing plant in Bhopal. Pesticides are substances, which shield crops from being damaged by pests. Pesticides are toxic chemicals. In December 3, 1984, a fatal gas, namely, Methyl Isocyanate (MIC) started leaking from a tank at UCIL Bhopal plant. Due to leakage of this fatal gas, approximately 3,800 people lost their lives and many other suffered other health related ailments.

Human life is precious and nothing can compensate the loss of a life. The company was bound to pay compensation to the dependents of the victims to lost their lives. UCIL had to compensate for the damages caused.

Even though human life is invaluable but this situations like these Insurance acts as a big relief. Insurance helps to recover the losses to some extent as the resulting financial liabilities could be transferred to the insurer. Insurance acts as a preventive measure for the unforeseen events, which reduces the financial burden.

Ultimately, an Act was introduced to provide damages to the sufferers of the accidents, which has resulted due to the handling of hazardous chemicals. The Act is Public Liability Insurance Act, 1991, which is applicable to all the owners, related with the manufacturing or handling of the hazardous substance.

Workmen Compensation Act, 1923 also provide compensation to employees in case of injury at the workplace. The employer is liable to pay compensation to the injured employee in case of mishappening. The amount of compensation depends on various factors like nature of the injury, age of the employee, the average monthly wage of the employee.

Furthermore, if the victims who died in the Bhopal gas tragedy had their lives insured, their families would have received some amount of money as help. Money cannot compensate anyone’s life but it can surely act as some support to tide over their loss. In today’s time of uncertainty, everyone must take the benefit of insurance.

Conclusion
Indian economy is growing rapidly. There are several new players in the insurance industry, which has opened new opportunities and has contributed the employment generation. Insurance awareness is very important at different levels of the society. Individuals should know the importance and the consequent benefits of insurance. In order to achieve higher levels of penetration and spread of insurance among larger sections of the population, the insurance companies should pay more concentration on the rural communities rather than the urban and the higher segment of the society. With IRDA in place, the insurance sector is regulated and the interest of the policyholders is ensured. IRDA also has to bring necessary changes whenever required in consultation with the stakeholders.
Privatization has been extended over large part of the world in past two decades embracing the industrial economies, transition economies of East Europe and less developed world (Ram Mohan, 2005). In recent years, many industrially advanced countries as well least developed countries have been taken macroeconomic reforms, which involved structure adjustment programme. The financial sector which typically owned or controlled by the state itself was the focal point of attention. The developing countries like India along with other semi industrialised countries have opened up their financial sector (Mitra & Ghosh, 2010b). The Twentieth Century A.D beheld two great transformations, nationalization in the first half of the century, the process of which extended to considerably large portion of the century and privatization in the last two decades of the century, the process of which is still rolling on (Faiz, 2008).

When nationalization went down in line, countries believed that the change of the ownership from private to public would be able to solve most of the social, economic and political problems of the economies (Faiz, 2008). State-led policies, programs, and performance earmarked for critics because of the growing resentment among citizens with bureaucratic inefficiencies, diminishing performance of public enterprises, shrinking public confidence in government institutions, worsening situation of inflation allegedly caused by public sectors deficits and endorsement for market-driven remedies. This criticism for state-centred policy was reinforced further by the decay of major socialist states and the worldwide adoption of market ideology. Therefore, the period between early 1980s and late 1990s saw the escalation of market-centred policies all over the world. In developing countries, the market-driven policies such as liberalization, deregulation and privatization were embraced or forced under stabilization and structural adjustment programs. Among these policies, however, the privatization of public resources, projects, and services has been one of the most persuasive and noticeable changes in the recent history of strategic reforms. Such a pivotal policy change justified on various grounds and brought by various national and international factors has serious economic, political, and social implications for developing nations (Haque, 2001).

“Is globalization good?” is a moot point among economists. To some people, globalization is a brave new world with no barriers, while to others it spells doom and disaster (Lamsal, n.d.). Neoclassical economists hold that countries should deregulate industries and liberalise markets. In the theory, this will stimulate greater efficiency, greater professionalism in the market, proliferation of more products and services and expansion of market. Contrary to this, a growing number of economists are challenging the benefit of deregulation (Devi, 2011).

Liberalization and Privatization Concepts

Liberalization is a process through which market forces gain priorities in resource allocation and price setting in contrast with government (Roland, 2008). Liberalization, especially economic liberalization is purging and trimming of state monopolies in the economic sphere. Privatization has been perceived as a centrepiece of economic liberalization and bracing public sector efficiency by ensuring private sector participation in the economy. At the micro level, privatization is the handover of responsibilities, management and ownership held by the government sector to private sector. At a macro level, privatization may be considered as transformation of public sector led mixed or socialist economy into a
private sector-dominated market economy. At the broadest level, privatization is economic liberalization bringing market forces into the economy (Lamsal, n.d.). Privatization is indeed a product of the 1980s. The word found its way into a standard dictionary in 1983 (Ram Mohan, 2005). The term ‘privatization’ was devised long before but the privatization as policy is the product of the 1980s. The term was coined in 1936 in a chronicle published in the Economist (Faiz, 2008). Privatization in simple words refers to the process of transfer of ownership of state-owned or public owned property to individuals or groups that intend to utilize it for private benefits and run entities with the aim of profit maximization (Kousadikar, 2013). Privatization may also be considered as any material transaction by which the state’s ownership of corporate establishment is reduced (OECD, 2009). The word “Privatization” has been receiving much attention in business, government and academic community all over the world. Actually, the language and programme of privatization have spread so rapidly throughout the world that the phenomenon can be linked to a revolution or a boon (Faiz, 2008). During the past two decades, various forms of privatization regardless of their economic conditions, ideological positions and political orientations were launched by the governments all over the world. This current trend represents a reversal of the traditional post war policy based on the belief of welfare state, planned development and public-sector-oriented economic growth which prevailed in both developed and developing nations during the period between the 1950s and 1970s (Haque, 2001). It is generally hold that the private sector has higher efficiency in their working since it seeks to maximize profit and in such a condition limited resources of society are utilized optimally and efficiently. Now if privatization process is considered as a basic step towards economic growth and opulence of industrial market economies, it can be hoped that higher economic growth and development will be achieved as the privatization spread in the countries (Rahbar, Sargolzaei, Ahmadi, & Ahmadi, 2012).

Rationale of Privatization

Many industrial advanced countries, socialist economies and developing countries belonging to Asia, Africa and Latin America have introduced mammoth agenda of privatization during the last two-three decades. Many industrial market economies have brought out the programme of privatization on their own privilege, while many developing countries were obligatory to undertaken privatization as a condition for assistance under the economic stabilisation and structural adjustment programmes by International Monetary Fund (IMF) and World Bank. Privatization is generally perceived to have positive outcome. Privatization has ameliorated welfare, profitability, returns to owners and stakeholders, and economic efficiency. But public perceptions of privatization are generally negative and they are getting worse (Birdsall & Nellis, 2005).

There are two broad groups about the possible outcomes of this reform process pointed at financial liberalization: the Goldsmith- McKinnon-Shaw school and Keynes-Tobin-Stiglitz (also called the Structuralist and Neostructuralists School). Each of these groups provides background, rationale and intellectual justification for financial liberalization. McKinnon and Shaw made it clear that the lack of financial deepening was a major hurdle to growth and development (Sen & Vaidya, 1998).

Financial liberalization stimulates productivity in the economy by providing higher incentives to save and enhancing the allocation of funds to the most productive and profitable projects (Ahmed & Islam, 2010). This view is opposed by the Keynesian- Tobin-Stiglitz school of thought. This group (called neostucturalists) has brought forward a number of economic rationales to justify government intervention in the area of prudential regulation and supervision, particularly due to the de facto role of government as an insurer of the financial system (Ahmed & Islam, 2010).

According to the some scholar on privatization, the rationale for privatization is as follows:

Positive Rationale

In general, privatization has been undertaken under the aegis of increasing economic efficiency, streamlining public sector, lessening government borrowing, reducing deficits, generating government
revenues, reducing state influence in economy, persuading market forces, enhancing competition, amplifying customers’ choices and upgrading service quality (Ghosh, 2013; Haque, 2001). In most countries and sectors around the world privatization yields great benefits at the firm level and macroeconomic level and there is strong correlation between liberalization and return to growth (Nellis, n.d.). Financial liberalization helps to raise growth rate through a number of direct and indirect channels (Sadak, 2005). Some of these directly affect the drivers of economic growth by enhancement of domestic savings, reduction in the cost of capital and transfer of information & communication technology. Indirect channels which in some cases could be even more important than the direct ones include production specialization, better risk management and improvement in macroeconomic policies (Hrab, 2004).

The rationale behind privatization programs in the developing world is the belief that it will increase efficiency through entrepreneurial management and competition, foster economic growth, increase flow of goods and services underpinned by the developments of technology, and enlarge job opportunities in domestic market (Bhattacharya, 2004; Errunza & Mazumdar, 2000). Ahmed and Islam (2010) have briefly discussed some areas where we can have some changes as a result of financial liberalization (a) increase in propensity to save and more savings available to investors, (b) allocative efficiency and improved performance of investment, (c) reduction of corruption and rent-seeking activities, (d) level of competitiveness, and (e) curb market rate. Some other important reasons for privatization are development of product markets, factor markets and security markets. Welfare economist assumed that efficiency can be reached through competitive marketplace. If privatization stimulates competition, privatization can lead to greater efficiency (Parker & Saal, 2003).

Some scholars tend toward the major rationales of privatization in terms of the following four categories (a) the efficiency argument, which assumes state enterprises responsible for inefficiencies and advocates privatization for better outcomes (Haque, 2001; Walle, 1989), (b) the property ownership argument, which makes the allegation that public ownership is discouraging managers in public enterprises to work efficiently since they have no stake in them (Haque, 2001), (c) the distortion argument, which assumes government intervention liable for creating distortion in resource allocation (Haque, 2001), and (d) the fiscal argument, which considers excessive government intervention as the root cause of budgetary deficits. It is perceived that divestiture will cut government expenditures and help to restore budgetary balance (Haque, 2001; Walle, 1989).

Critical Rationale

Beyond the formal or positive rationale of privatization, there are some pushing factors both internal as well as external behind this radical policy change.

1- The decision to privatize was mainly taken because of fiscal necessity, rather than desire for improved efficiency. Government had raised huge amount by selling state owned enterprise which could be seen as a potential solution to reduce fiscal deficit in many countries or to improve government’s finances. Therefore, Privatization can be a result of failure of state ownership (Katsoulakos & Likoyanni, 2002; Parker & Saal, 2003; Sunderland, 2011). In India, when economic reforms began in 1991, the country had confronted with severe balance of payments crisis. Countries that privatized at full tilt did so either because of critical macroeconomic conditions that include hyperinflation, declining GDP, and balance of payments crisis or a sharp political discontinuity leading to a regime change. Under these circumstances, hard economic healing was up to mark. Privatization was a convenient way to reduce the fiscal deficit and raise foreign exchange, e.g., by selling state enterprises to foreign investors and increase FDI (Kapur & Ramamurti, 2002).

2- In most countries, privatization usually reflects the prevailing state ideology which has been marked as neoconservative, neoliberal or new right position holding pro-market assumptions and favouring market-oriented policies such as privatization, deregulation, subsidy cuts, free trade, market-
based interest and exchange rates, foreign direct investment and secured property rights. It has already been acknowledged by some scholars that in advanced developed nations such as Canada, U.K. and U.S., privatization has been an ideologically charged phenomenon which came into the force not due to its intrinsic strengths but due to the influence of neoconservative political leaders and highbrows believing that the private sector is surpassing the public sector. More specifically, the prominent political leaders of the 1980s including Margaret Thatcher in the U.K., Ronald Reagan in the U.S., and Brian Mulroney in Canada allegedly had such neoliberal or neoconservative ideological predispositions (Faiz, 2008; Haque, 2001).

3- Beyond the ideological influence on top policy makers, there were various forms of external pressure which led to the proliferation of privatization in developing countries. Especially for Latin American countries, the propagation of neoliberal approach profoundly was due to rigorous international pressure aggravated by their huge external debts. It has already been pointed out by some experts that vogue of privatization in developing countries went beyond ideological belief, and was considerably determined by international agencies and multinational banks (Haque, 2001). Liberalization and privatization can also be a result of bilateral/multilateral arrangements. The mammoth players in the global marketplace have a crucial interest in liberalization particularly due to saturation in industrialized countries, strong growth in emerging countries, potential future growth in emerging markets, expected efficiency gains through diversification, economics of scale, etc.

4- Finally, The leading political parties have tried to gain public support and win elections by using the privatization rhetoric (Haque, 2001). Therefore, Privatization can also be a political decision taken without proper analysis or consideration of possible short or long-term impact on poverty and income distribution (Nixson & Walters, 2004).

Shortcomings of Privatization

Privatization has plausible implication on social, economical and political landscape of a country but it also has certain critical implications on developing countries.

1. Firstly, in terms of internal economic implications: It is generally argued that the privatization by no means saw any significant improvement in the developing world in terms of expunging poverty, reducing unemployment, bridling trade imbalance, accelerating economic growth and bring down external debt and dependence. Private enterprises tend to retrench workers, introduce capital-intensive technology, hire foreign labour demanding lower wages and worsen unemployment (Haque, 2001). Privatized economy is most of time confronted with a situation where levels of poverty and inequality is rising and overall growth rate in current and projected income per capita become too low to dwarf the increases in inequality and poverty (Nixson & Walters, 2004).

2. Secondly, with regard to adverse social implications: Privatization is usually exacerbated income gaps and creating loathsome distributional effects in developing countries. It is all because when the profit-making state enterprises are privatized, the incomes generally shift from public exchequer representing all tax-paying citizens to few opulent investors. Private firms are focus more on profits, prices and costs rather than social objectives (Bayliss, 2002; Kousadikar & Singh 2013). At the centre of all criticism is the notion that privatization has been hard-pressed the poor, beleaguered workers, and privileged the few affluent and powerful. Privatization is throwing people out of work or squeeze them to accept jobs with lower pay and less security, raise prices of goods and services, bestow opportunities to corrupt, and generally makes the rich more richer and the poor more poorer (Birdsall & Nellis, 2005).

3. Finally, in terms of critical political implications: There has been a concern that privatization may be antithetical to democratic institutions due to the shrinking public support for such a policy that may have adverse impact on various state-led social programs. Another political implication of market-based policy has been the increasing power of organized capital and the diminishing power of the working class. This is particularly due to the shift of resources and decisions from the public sector to the private sector as well as delineation of trade unions (Haque, 2001; Walle, 1989).
Privatization in India

After independence, India got a choice of how to run the economy. Jawaharlal Nehru, the first prime minister of India, was enormously influenced by the avowed success of Soviet planning. He believed that capital-intensive industries ought to be handled by the state. This socialist bent led to nationalization of banks, coal, insurance, and other industries (Sinha, n.d.). Rajiv Gandhi became the Prime Minister of India and initiated a process of simplifying licensing process in the budget of 1985–86 which lasted until 1987 when reform was abandoned. But, the regulations were nevertheless unaffected. Liberalization eventually returned to India in a much more dramatic and lasting form in 1991 (Jenkins, 2003).

In India, it is unlikely that the Narasimha Rao government would have embraced economic reforms out of a genuine desire to lift the performance of the Indian economy if the macroeconomic crisis of 1990–91 had not pushed the country to the stage of near bankruptcy. The economy tread on the heels of crisis due to some policies followed during the 1980s. This forced the Rao government to accept International Monetary Fund and World Bank help on the condition of economic reforms (Chai & Roy, 2006). Fiscal imbalances in India which assumed serious proportions since the mid 1980s had two important facets. First, the outpacing of revenues growth by expenditure growth considerably restrained the resources available for public investment in the economy. Second, the increasing diversion of household savings to meet public consumption requirements not only expand public debt to unfeasible levels, but also reduced the resources available for private investment and resulted in unprecedented balance of payments crisis (Bajpai, 2002).

The debilitating blow of rising fiscal deficits and the steep rise in oil prices during the Gulf crisis of 1990 had put pressure on exchange rate and fuelling expectations about imminent devaluation of the currency. Political instability in 1990, as reflected in two changes of prime ministers within a year led to lack of confidence of Non-Resident Indians (NRIs) in the government’s ability to manage the economy. The expectation of devaluation of rupee and the fall in confidence led to withdrawal of deposits in Indian banks by NRIs and withdrawal of capital by other external investors. Foreign exchange reserves dwindled to a level that was less than the cost of two weeks’ worth of imports. The spectre of default on short-term external loans loomed and led to downgrading of India’s credit rating (Srinivasan, 2003). To burst out of this dire macroeconomic and balance of payments situation, India’s new government got to grips with a fairly comprehensive policy reform package. The reforms tried to consciously fashion the new policy. Long time critics of India’s development strategy widely welcomed this change (Nagaraj, 1997).

The major thrusts of reforms were (a) stabilization and macro-economic balance through fiscal, monetary and exchange rate policies, (b) liberalized trade regime with no import licensing and tariff rates, (c) an exchange rate system which makes rupee convertible at least for current account transactions of balance of payments, (d) a competitive financial system with sound regulations, (e) an industrial sector free of many controls, and (f) an autonomous, competitive and streamlined public sectors (Satija, 2009). The Indian government had undertaken fundamental changes in the content and approach to economic policy through pro-market policies, which are classified into (a) fiscal policy reforms including tax reforms, expenditure management, restructuring of the public sector and fiscal & monetary coordination, (b) financial sector reforms including banking sector and capital market, (c) industrial policy and abolition of the license system, (d) foreign investment policy reforms, (e) reforms in the external sector covering foreign trade and exchange rate policies, and (f) agricultural sector reforms regarding internal and external trade in agricultural commodities (Ghosh, 2013).

Extending the ongoing reforms, the Government of India promulgated in the budget of 1998-99 that stake of Government would fall to 26 per cent in PSEs (Public Sector Enterprises) except in the strategic enterprises where the Government will continue to hold the majority of shares. In the same year, the Government of India announced that the strategic enterprises only covered (a) arms, ammunition and defence equipments, (b) atomic energy except use of nuclear power in agriculture, and
(c) railway transport (Ram Mohan, 2005). In the following budget of 2000-01, the state was willing to
reduce the Government’s share even below 26 per cent in non-strategic enterprises if any economic
urgency arises (Faiz, 2008).

Economic & Financial Sector Reforms

Financial liberalization is a pre-eminent part of the process of economic liberalization. Financial sector
reforms were started in India in 1992–93 to promote a diversified, efficient and competitive financial
system. India’s financial sector liberalization has been a comprehensive program involving issues related
to banking, capital market, fiscal policy and international financial integration (Sadak, 2009). Financial
sector reforms include banking sector and non-bank financial sector. The non-bank financial sector
includes reforms relating to the capital market, development finance institutions, insurance and mutual
funds and liberalization of capital flows (Joshi, 1996).
The three influential reports by the Chakravarty Committee (1985), the Vaghul Committee (1987) and
the Narasimham Committee (1991) & (1998) gave impetus to financial sector reforms. The first committee
suggested ways of activating treasury bills market so that open market operations could gradually become
the dominant instrument of monetary policy. The second committee recommended phased decontrol of
money markets and gradual integration of these markets with other short-term markets such as the
treasury bills market (Sen & Vaidya, 1998). Mr.
M. Narasimham, a former RBI governor was the chairman of the Committee on Financial Systems (CFS)
and the Committee on Banking Sector Reforms (CBSR). The report of CFS was submitted in 1991 and
that of CBSR was submitted in 1998. The CFS took note of excessive administrative and political
interference in internal management and credit decision making in public sector banks. The CBSR was
formed to review the progress made in reforming banking sector and to chart the actions needed to
strengthen the foundation of banking system. The CFS and CBSR (henceforth the first and second
Narasimham Committees) provided the blueprint for reforming the financial system (Bery & Singh, 2006).
RBI has implemented several key recommendations of the Chakravarty committee and the Vaghul
committee with introduction of scheme of 182 days treasury bills in 1986, foundations of The Discount
and Finance House of India (DFHI) in 1988 and introduction of commercial paper and certificates of
deposit in 1989. Consequently, by late 1980s, there was inevitable deregulation and development of short-
term segment of financial market with little development in credit and capital market (Nandy, 2010).
More radical reforms had to wait till the endorsement of structural adjustment cum stabilization program by Indian government in 1991. The pre-eminent reforms included deregulation of interest rates, advancement of securities markets, building a credible risk-free yield curve, greater reliance on open market operations, auctions of government securities, phased decontrol of the capital account and streamlining supervision of banking sector with international standards & practices. However, neither committee took up the cudgels for denationalization (Bery & Singh, 2006).
Banking sector reforms were major point of attention in Rao government. Consequently, a number of
measures specific to banking system were undertaken to ameliorate its long term viability as a commercial
entity. The self determination of price for banking products on commercial considerations, moderation in
various balance sheet restrictions in the form of statutory pre-emption and introduction of prudential norms
pertaining to income recognition, asset classification and capital adequacy were some measures of banking
sector reforms. The early manoeuvre in banking sector was geared towards withdrawing the functional &
operational constraints encroaching on banks’ operations and providing them greater operational autonomy
(Misra, 2007).
As far as capital market reforms are concerned, several plans have been prepared in past few years to
ensure smooth functioning of capital market. The capital market reforms witnessed first move when the
Capital Issues (Control) Act of 1947 was rescinded and the office of Controller of Capital Issues
abolished. The Securities and Exchange Board of India was established to ensure limpidity of trading
practices, speedy settlement procedures, full disclosure for investor protection and supervising market intermediaries in the capital markets (Gupta, 1998; Vashisht, 2002; Vijayakumar, 2012). Some important initiatives taken as part of reform process opened up doors of capital market for foreign institutional investors and allowed Indian companies to access international capital markets by the mechanism of global depository receipts and favourable tax treatment (Ahuwalia, n.d.). To provide greater transparency, anonymity and lower transaction cost, a nationwide ‘screen-based trading’ system was introduced in 1992, through establishment of National Stock Exchange (NSE) (Ansari, 2006).

As far as external payment regime is concerned, most of restrictions on current transactions were withdrawn. The exchange rate regime is officially described as market driven with no target rate, but RBI reserves the right to intervene in the market and guide the exchange rate in the directions of appropriate competitiveness (Bery & Singh, 2006).

One can broadly classify the financial sector reforms as being three-pronged aimed at (a) liberalizing the overall macroeconomic and regulatory environment within which financial institutions function, (b) strengthening the institutions and improving their efficiency & competitiveness, and (c) establishing and strengthening the regulatory framework and institutions for overseeing the financial system (Chanda, 2008). As a corollary of these reforms, there has been a rapid growth in the extent of monetization and financial intermediation in the economy. Various financial entities outside the banking segment including mutual funds, non-banking financial companies and primary dealers have come to play an important role in resource mobilization and allocation. The role of the private sector has also been increased.

Insurance Sector Reforms

The Indian insurance industry was revolved around two public sector players, viz., Life Insurance Corporation of India and General Insurance Corporation of India. LIC has been operated in the life segment lodge in the people brain by providing wide range of services, building an extensive network of branches and offering employment to a large number of agents. The non-life insurance sector was overwhelmingly dominated by GIC. One of the major impetuses for the nationalization of insurance companies in 20th century was to channel greater resources towards development programs. It also sought to increase insurance market penetration and bring down incidence of failures of insurance companies which were thought to be a result of mismanagement. But, in the post-nationalization period, GIC and LIC funds were nevertheless used to finance government deficits and this severely constrained their operations. Moreover, these corporations were also asked to channel funds towards meeting social objectives. With the initiation of reforms in financial sector in early 1990s, the need to restructure insurance sector was realized (Gupta, n.d).

Malhotra Committee

A move to liberalise insurance sector was taken in April 1993 with establishment of Malhotra committee so called committee on insurance sector reforms. Malhotra committee was headed by R. N. Malhotra, a former finance secretary and governor of Reserve Bank of India. “The Committee was established to assess insurance sector strengths and weaknesses in terms of the objective of providing high quality services to the public and serving as an effective instrument for mobilization of financial resources for development, to review the then existing structure of regulation and supervision of insurance sector and to suggest reforms for strengthening and modernizing regulatory system in tune with the changing economic environment” (“Consultation Paper on Revision of The Insurance Act 1938 & The Insurance Regulatory and Development Authority of India Act 1999,” 2003; “Malhotra committee recommendation,” 1998). The Malhotra Committee recommended introduction of concept of “professionalization” in the insurance sector (Dutta, 2012). The committee recommended opening of insurance sector to private players and setting an independent regulatory authority to create a level playing field for all entities. The terms of reference of the said committee were:
1. To review present structure of insurance industry and to evaluate its strength and weakness in term of offering wide-range of insurance products with a high quality of services to public and operating as an effective means for mobilisation of financial resources for development of the economy; 
2. To formulate recommendation for modifying structure of insurance industry and general framework of policy consistent with the structural changes in the economy and financial sector; 
3. To make precise proposal regarding the LIC and GIC with a view to improve their functioning in changing economic environment; 
4. To examine present structure of regulations and supervision of insurance sector and to make suggestions for strengthening and modernising the regulatory system in dynamic economic environment; 
5. To review and make suggestions on the role of surveyors, intermediaries and ancillaries of the insurance sector; 
6. To make suggestions on such other matters as the committee considers relevant for the growth and development of insurance sector (Sethi & Bhatia, 2007).

The Malhotra Committee came up with the recommendations in January 1994. The committee appointed a private opinion poll agency to conduct a market survey for finding out satisfaction level of users of life insurance and assess their perceptions on possible liberalization of insurance sector. Based on the findings of survey, the committee underlined some positive and negative aspects of development of LIC which are stated as under:

On the positive side, 
1. LIC was proliferated insurance culture widely across India, 
2. Huge amount of saving was mobilised for national development and fund was used to finance social sectors such as housing, electricity, water supply, sewerage, medical and education, 
3. LIC was a name of trust among insuring public, and 
4. A large pool of talented insurance professionals was built up. 

On the negative side, 
1. The enormous market and service network of LIC was inadequately responsive to customer needs, 
2. There was lack of insurance awareness among the public, 
3. Lack of life insurance product with reference to the customer needs, 
4. Term assurance plans were not encouraged and unit linked products were not available, 
5. Price of insurance products were quite high and return from life insurance was significantly lower than other saving instruments, 
6. LIC was facing some serious problem due to mismanagement and poor structure. The central and zonal offices were excessively overstaffed, 
7. Work culture within the organisation was not satisfactory, 
8. Trade unions had indulged in restrictive practices, 
9. The efficiency of the organisation and quality of customer service had seriously affected due to lack of computerization (Mitra & Ghosh, 2010b).

“The Malhotra Committee touched both life and general insurance business. The report of the committee covered three major topics (a) liberalization, restructuring and regulation of insurance, (b) pricing of product and distribution of services, and (c) surveyors, reinsurance and ombudsmen (Siddaiah, 2012). The main recommendations of Malhotra Committee were:

Liberalization

Liberalization of insurance industry by permitting domestic and foreign private players was among the several important recommendations the committee made so far. Monopolies are awful in themselves especially when they are government monopolies because they do not keep themselves viable. At the time of nationalization of insurance business, it could have been known that state monopolies would not survive over a long time or lead to lack of competition. Yet, at that point of time, it was believed that
control over huge funds and their utilization was absolutely necessary to ensure fulfilment of state priorities for investment (Palade, Shah, & Lunawat, 2008). Therefore, Malhotra committee recommended that state monopoly of insurance sector should be broken up by allowing domestic and foreign private firms in the market. The idea behind this measure was to ensure utilization of untapped potential, introduction of competition, expansion of business and better choices to customers in terms of variety of products, reduction of prices and efficient customer service. In this direction, committee recommend certain measures to be taken (a) no firm should be allowed to do business in both life and general insurance, (b) insurance regulatory authority should be regulatory authority of insurance companies, (c) auditors of the insurance company should report to insurance regulatory authority, and (d) entry to foreign insurance companies should be on selective basis i.e. they should be required to float an Indian company preferably by way of joint ventures with Indian partners (Kumar, 2010; Rao, 2000). In order to ensure financial strength of insurance companies, the committee recommended three basic measures to be taken (a) new entrant should have minimum paid up capital of Rs 100 crores except in case of state level co-operative institution, (b) the promoters’ holding in a private insurance company should not be more than 40 per cent of the total and less than 26 per cent, and (c) no person other than the promoter should be allowed to hold more than 1 per cent of the equity (Bhaumik, 1999). The limitation on capital ownership would restrict contribution to those who have a clear sense of responsibility to the corporation. Nobody should be allowed to have monopoly control over the corporation by owning a large chunk of the capital (Venugopa, 2007).

Supervision and Regulation

On nationalization of life insurance in 1956 and general insurance in 1973, LIC and GIC were provided with most of the regulatory function which became previously carried by Controller of Insurance (COI). Though COI a statutory body attached to the ministry of finance continues to be the supervisory and regulatory authority for insurance industry. To ensure prudent practices while opening insurance industry to competition, the committee recommended that COI should be empowered as prescribed in the Insurance Act. It was also proposed that a multimember statutory body on similar lines to SEBI having full functional autonomy and operational flexibility should be established in order to create a level playing field for all insurers. Therefore, establishment of insurance regulatory authority with supervisory and regulatory powers covering all aspects of insurers in conducting transparent and smooth business was among the important recommendation of committee. In brief, insurance regulatory authority should be act as regulator, controller, supervisor, initiator, conductor, mediator and detector of insurance industry. In order to keep it as an autonomous body, the committee recommended that 0.05 per cent of yearly premium income of insurance companies be levied to finance its establishment and activities (Rao, 2000).

Restructuring

The committee observed that both life and non life insurance sector is facing some serious problem due to mismanagement and poor structure. Therefore, committee proposed restructuring of LIC and GIC. Life insurance sector: The committee recommended that work should be divided between central and zonal offices of LIC. Central office should concentrate on policy formulation, review and evaluation, pricing and actuarial assessment, product development, personnel policies, investments polices, systems development, etc. Zonal offices should look after the insurance business and related matters. It is generally viewed that state ownership lead to delay and rigidity in decisions making. Therefore, LIC's should be bringing out of state ownership. At that time, LIC had a capital of Rs. 5 crore, contributed entirely by the central government. This amount is not adequate for a life insurer giant. Therefore, committee recommended that capital of Rs 5 crore should be raised to Rs 200 crore, where 50% should be held by the government and the rest by the public at large including company employees (Kapila, 1996).
Non Life insurance sector: The committee recommended that insurance companies should reorganize the staff structures and hierarchies in their offices. At that time, the four subsidiary companies were over-staffed in their head offices, regional offices and even divisional offices. Many metropolitan and urban branches were over-staffed; rural and semi-urban branches were often under-manned. Therefore, it became necessary to utilize excess staff for strengthening the branches. There were also numerous restrictive practices which need to be eliminated in order to revamp work culture and productivity. Furthermore, GIC and its subsidiaries were come within the definition of “State”, since the total share capital was directly or indirectly contributed by the Government of India. In the committee’s views, broad basing their shareholding is needed to operate in a more competitive environment. As far as GIC is concerned, it was proposed that GIC should cease to be a holding company of four of its subsidiaries and should act as a national reinsurer. It was further recommended that share capital of GIC should be raised to Rs. 200 crore from its present level of Rs.107.50 crore, where 50% of the equity should be held by the government and the rest by the public at large including employees of GIC. As far as the four subsidiary companies are concerned, it was proposed that they should operate as independent companies run by a board. It was further suggested that the equity capital of each of these companies should be raised to Rs.100 crore with 50% holding by the government and the rest by the public including employees of the respective companies (Kapila, 1996).

Investment Regulations

Keeping in view present developments in the capital market and stiff competition from other saving institutions, the Malhotra committee recommended certain modifications in mandated investment pattern followed by insurance companies. The committee recommended that (a) investment in central government securities should not be less than 20 per cent and the special deposits with government should continue to be considered as investment in central government securities, (b) state government securities and government guaranteed securities inclusive of central government securities should be not less than 40 per cent as compared to the existing 50 per cent, and (c) investments in socially oriented sectors including above should not be less than 50 per cent as compared to the existing 75 per cent. However, no changes should be made to the present level of investments in other than approved investments. Furthermore, investments of any insurer should not be more than 5 per cent of the subscribed equity share of any company (Venugopal, 2006).

Rural Insurance

The committee proposed that life insurance should provide cheap term insurance coverage to relatively backward sections of society including working women. For bringing insurance to door step of rural people, institutions including panchayats, voluntary organisations, mahila mandals and co-operatives should be sought. Apart from these, new entrants into the life insurance business should be mandate to underwrite a specified proportion of their business in rural areas and penalties are to be imposed by the Insurance Regulatory Authority for defaulters. The sponsored relief-oriented welfare schemes except those having an element of insurance should be transferred from LIC to concerned government authorities (Rao, 2000). Postal life insurance should be allowed to operate in the rural market.

Pension Funds

Pension fund schemes should be fully exempted from tax. Private pension funds should be allowed to pay pension to their members under the careful scrutiny of regulatory authority and unit-linked pension plans should be popularised. The committee emphasised that contribution to pension funds by self-employed professionals, traders and workers in the unorganized sectors should be promoted. It is suggested that substantial concessions should also be available for contributions to pension funds and this should cover schemes managed by all the insurance companies as well (Kumar, 2010).

Customer Service
Information and processing technology was insufficient to carry out number of statistics for efficient rate-setting and supervision of insurance business. There should be an integrated and effective management information system. The committee was set up a time limit of 12 to 18 months for comprehensive computerisation in LIC. The Committee believed that imaginative and prudent use of information technology would be lead to efficient customer service, effective management and meaningful regulation (Kapila, 1996). For ensuring efficient customer services, the committee further recommended that LIC should continue as a single entity, pay interest on delays of claim beyond 30 days, use the revised mortality table and revise premium after every 10 years. With regard to general insurance industry, the committee recommended that the institutions of ombudsman should be set up (Bhole & Mahakud, 2009; Gulati, 2007).

Immediately after the recommendations of Malhotra committee, a new committee (called Mukherjee committee) was formed in 1995. The Mukherjee committee submitted its report in 1997, but recommendations of Mukherjee committee never made public. Information from unofficial sources unfolded that the committee proposed inclusion of certain ratio in balance sheet of insurance companies to bring more transparency in accounting standards.

Insurance Regulatory and Development Authority of India

The enactment of any legislation is not facile process. It requires lot of efforts and time especially with reference to India. Based on the recommendation of Malhotra committee regarding establishment of a strong, effective and independent regulatory body to protect interest of policyholders and development of insurance industry, the Government of India had established interim regulatory authority in January 1996 through an exclusive order. Later on, this Interim Regulatory Authority becomes Insurance Regulatory and Development Authority of India (Kumar, 2010).

The constitution of IRDAI is a landmark in landscape of financial sector. The Insurance Regulatory and Development Authority of India Act provides for composition of IRDAI, tenure of office chairperson and other members, removal from office, salary and allowances of chairperson and members, duties, power and function of IRDAI, finance, account and audit, and other miscellaneous provision (Insurance Regulatory and Development Authority of India Act, 1999). Insurance Regulatory and Development Authority of India Act made several amendments to the Insurance Act 1938, LIC Act 1956 and GIC Act 1972 which revoked the monopoly conferred to the Life Insurance Corporation of India and General Insurance Corporation of India (Karthikeyan, 2007; Raja Babu, 2012).

IRDAI as an autonomous body was formed on April 19, 1999. IRDAI entrusted with the task of regulating, supervising and developing insurance and re-insurance business in India. IRDAI started its functioning on April 19, 2000 headed by N. Rangachary as its first Chairperson with 4 full-time directors, 2 part-time directors and 25-members in Insurance Advisory Council. The members of the council represent various industries and professions (Narula, 2012).

IRDAI as a regulatory authority has heavy responsibilities and difficult roles to play. On the one side, it has to protect against malpractices and secure fair treatment to policyholders. On the other side, it has to impose restrictions in such a manner that growth of insurance industry is not hampered. IRDAI regulations cover minimum requirements for best practices in the area of licensing, prudential regulations and requirements, supervisory powers, managing asset qualities and enhancing corporate governance.

Objectives of the Insurance Regulatory and Development Authority of India

1- To protect the interest of policyholders of insurance policies;

2- To bring about speedy and orderly growth of the insurance industry and to provide long term funds for accelerating growth of the economy;
3- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
4- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery;
5- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
6- To take action where such standards are inadequate or ineffectively enforced;
7- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

Functions of Insurance Regulatory and Development Authority of India

1- Issue to the applicant a certificate of registration; to renew, modify, withdraw, suspend or cancel such registration;
2- Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
3- Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
4- Specifying the code of conduct for surveyors and loss assessors;
5- Promoting efficiency in the conduct of insurance business;
6- Promoting and regulating professional organisations connected with the insurance and re-insurance business;
7- Levying fees and other charges for carrying out the purposes of this Act;
8- Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
9- Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
10- Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
11- Regulating investment of funds by insurance companies;
12- Regulating maintenance of margin of solvency;
13- Adjudication of disputes between insurers and intermediaries or insurance intermediaries;
14- Supervising the functioning of the Tariff Advisory Committee;
15- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
16- Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
17- Exercising such other powers as may be prescribed.

Milestones in Post Reform Period

1999 Introduction of Insurance Regulatory and Development Authority of India Act, 1999
2000 Constitution of IRDAI on 19th April, 2000 & Framing of Various Regulations Entry of domestic and foreign private firms into the Indian insurance market
Insurance Regulatory and Development Authority of India (Investment) Regulations, 2000
2001 Establishment of Life Insurance Council and General Insurance Council
Introducing Third Party Administrators for health insurance services
2002 Regulation on Protection of Policyholders' Interests
Introducing New Insurance Intermediaries: Brokers and Corporate Agents Four subsidiary companies of GIC became independent companies
2003 Referral Arrangement with Banks
Strengthening of Insurance Councils
2004 Various Committees / Working Groups on issues viz. Earthquake pool, Intermediaries, and Health Insurance
Regulation on qualifications of actuary
Guidelines for Unit Linked Insurance products
Report of KPN Committee on Provisions of Insurance Act, 1938
2006 Guidelines on Anti Money Laundering/ Counter Financing of Terrorism
Entry of Stand-Alone Health Insurance Company
2007 Guidelines on Advertisement, Promotion & Publicity of Insurance Companies, and insurance intermediaries
De-tariffing of General insurance sector
Creation of Motor Pool for Third party Insurance
2008 Benefit Illustrations for Unit Linked Products Innovation in Products
Strengthening on-site & off-site Monitoring
2009 Guidelines for Corporate Governance Guidelines on Health plus Life Combi Products
Grievance Redressal Mechanism
2010 Regulations on Treatment of Discontinued Linked Insurance Policies
Regulations on Sharing of Database for Distribution of Insurance Products Mandating Public Disclosures

Creation of IRDAI Grievance Call Centre & Guidelines for Grievance Redressal
2011 Framework for life insurance companies to raise capital through public issue Insurance Regulatory and Development Authority of India (Scheme of amalgamation and transfer of general insurance business) Regulations 2011 Insurance Regulatory and Development Authority of India (Issuance of capital by life insurance companies) Regulations 2011
Creation of Integrated Grievance Management System
Portability of Health insurance policies Mobile application to compare insurance products and premium rates
Insurance awareness initiative “Bima Bemisaal"
2012 Web Enabled Facility to Ascertain Insurance Particulars of Motor Vehicles Online application to compare Non Life Insurance products
Revised ULIP Guidelines
Creation of Consumer Education Website-for Public
2013 Insurance Regulatory and Development Authority of India (Issuance of Capital by General Insurance Companies) Regulations 2013
Insurance Regulatory and Development Authority of India (Health Insurance) Regulations, 2013
Insurance Regulatory and Development Authority of India (Places of Business) Regulations, 2013
Linked & Non-linked Life Insurance Regulations Insurance Repository System for Individual Policy Holders
Common Service Centres to sell simple policies in rural areas

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Circular on Insurance Fraud Monitoring Framework
2014 Report of the working group on File & Use guidelines for General insurance products
2015 The Insurance Laws (Amendment) Act, 2015, which provides for raising the foreign investment cap from 26 per cent to 49 per cent
Permission to set up IFSC Insurance Office in special economic zones
Norms on maintenance of insurance records
2016 IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd’s) (First Amendment) Regulations, 2016
IRDAI (Lloyd’s India) Regulations, 2016

Growth and Development of Indian Insurance Sector during Post Privatization
The growth and development of insurance sector has been one of the important objectives of insurance reforms. The insurance reforms in other countries resulted into higher growth of the sector. A natural question therefore arises that what happen to the growth of insurance sector since privatization of Indian insurance sector in 2000. Growth and development of Indian insurance sector is measured on the basis of insurance penetration and density, number of insurance companies, premium underwritten, new policies issued, expenses, profitability, equity capital, insurance offices and incurred claim ratio. To analyze the impact of insurance reforms on the growth of the insurance sector the study divides the insurance sector into life and non-life.

Growth of Life Insurance Sector
Growth of Non-Life Insurance Sector

Table 3.1: Life Insurance Penetration and Density in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Penetration (Percentage)</th>
<th>Density(USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>2.59</td>
<td>11.7</td>
</tr>
<tr>
<td>2002-03</td>
<td>2.26</td>
<td>12.9</td>
</tr>
<tr>
<td>2003-04</td>
<td>2.53</td>
<td>15.7</td>
</tr>
<tr>
<td>2004-05</td>
<td>2.53</td>
<td>18.3</td>
</tr>
<tr>
<td>2005-06</td>
<td>4.10</td>
<td>33.2</td>
</tr>
<tr>
<td>2006-07</td>
<td>4.00</td>
<td>40.4</td>
</tr>
<tr>
<td>2007-08</td>
<td>4.00</td>
<td>41.2</td>
</tr>
<tr>
<td>2008-09</td>
<td>4.60</td>
<td>47.7</td>
</tr>
<tr>
<td>2009-10</td>
<td>4.4</td>
<td>55.7</td>
</tr>
<tr>
<td>2010-11</td>
<td>3.4</td>
<td>49.0</td>
</tr>
<tr>
<td>2011-12</td>
<td>3.17</td>
<td>42.7</td>
</tr>
<tr>
<td>2012-13</td>
<td>3.10</td>
<td>41.0</td>
</tr>
<tr>
<td>2013-14</td>
<td>2.6</td>
<td>44</td>
</tr>
</tbody>
</table>

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.1 shows the life insurance penetration and density in India from 2001-02 to 2013-14. In the year 2001-02 life insurance penetration was 2.59 per cent which grew to 4.60 in 2008-09, but it finally slipped to 2.6 per cent in 2013-14. Table 3.1 further shows that life insurance density had been consistently gone up from USD 11.7 in 2001-02 to USD 55.7 in 2009-10 and slipped in consequent years to USD 49.0 in 2010-11, USD 42.7 in 2011-12 and further slipping to USD 41.0 in 2012-13. During the year under review 2014, the life insurance density was USD 44.
Table 3.2 shows total number of life insurance companies operating in India from 2001-02 to 2014-15. As the table depicts, there are 24 life insurance companies presently in operation, one is in public sector namely LIC and twenty three in private sector.

Table 3.3: Premium Underwritten by Life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>1</td>
<td>12</td>
<td>13</td>
</tr>
<tr>
<td>2002-03</td>
<td>1</td>
<td>12</td>
<td>13</td>
</tr>
<tr>
<td>2003-04</td>
<td>1</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>2004-05</td>
<td>1</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>2005-06</td>
<td>1</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>2006-07</td>
<td>1</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>2007-08</td>
<td>1</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>2008-09</td>
<td>1</td>
<td>21</td>
<td>22</td>
</tr>
<tr>
<td>2009-10</td>
<td>1</td>
<td>22</td>
<td>23</td>
</tr>
<tr>
<td>2010-11</td>
<td>1</td>
<td>23</td>
<td>24</td>
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<td>2011-12</td>
<td>1</td>
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</tr>
<tr>
<td>2014-15</td>
<td>1</td>
<td>23</td>
<td>24</td>
</tr>
</tbody>
</table>

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.3 given above shows the premium underwritten by life insurance companies in India. It can be seen from the table that life insurance industry underwrote premium of Rs. 50094.46 crore during the financial year 2001-02, which was increased to Rs. 291638.63 crore in 2010-11, but the total life insurance premium collection dropped in the year 2011-12 to Rs. 287072.11 crore. However following the year 2011-12 it increased to Rs. 328101.14 crore in 2014-15. Life insurance industry grew at a CAGR (Compound Annual Growth Rate) of 14.37 per cent. LIC recorded a premium income of Rs. 49821.91 crore in 2001-02 which was increased to Rs. 203473.40 crore in 2010-11, but LIC premium collection
slipped to Rs. 202889.28 crore in the year 2011-12. However following the year 2011-12 it increased to Rs. 239667.65 in 2014-15. LIC premium collection increased at a CAGR of 11.87 per cent. Private sector recorded a premium income of Rs. 272.55 crore in 2001-02 which was increased to Rs. 88165.24 crore in 2010-11, but private sector premium collection dropped in the subsequent years to Rs. 77340.90 crore in 2013-14. However, private sector premium collection was Rs. 88433.49 crore in 2014-15. Private sector premium collection increased at a CAGR of 51.14 per cent.

Table 3.4: Expenses of Life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Commission</th>
<th>Operating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private</td>
</tr>
<tr>
<td>2001-02</td>
<td>4519.31</td>
<td>4568.40</td>
</tr>
<tr>
<td>2002-03</td>
<td>5015.07</td>
<td>5168.09</td>
</tr>
<tr>
<td>2003-04</td>
<td>5742.91</td>
<td>6158.32</td>
</tr>
<tr>
<td>2004-05</td>
<td>6203.23</td>
<td>7057.96</td>
</tr>
<tr>
<td>2005-06</td>
<td>7100.19</td>
<td>10864.30</td>
</tr>
<tr>
<td>2006-07</td>
<td>9173.58</td>
<td>65122.83</td>
</tr>
<tr>
<td>2007-08</td>
<td>9614.69</td>
<td>86652.04</td>
</tr>
<tr>
<td>2008-09</td>
<td>10055.09</td>
<td>9064.29</td>
</tr>
<tr>
<td>2009-10</td>
<td>12132.56</td>
<td>12245.82</td>
</tr>
<tr>
<td>2010-11</td>
<td>13347.29</td>
<td>16561.11</td>
</tr>
<tr>
<td>2011-12</td>
<td>14063.06</td>
<td>14914.19</td>
</tr>
<tr>
<td>2012-13</td>
<td>14790.26</td>
<td>14760.19</td>
</tr>
<tr>
<td>2013-14</td>
<td>16762.88</td>
<td>14773.88</td>
</tr>
<tr>
<td>2014-15</td>
<td>15118.14</td>
<td>14466.14</td>
</tr>
<tr>
<td>CAGR</td>
<td>9.01%</td>
<td>37.74%</td>
</tr>
</tbody>
</table>

Table 3.4 shows the expenses of life insurance companies in India. Total commission expenses of life insurance sector stood at Rs. 19460.68 crore in 2014-15, as against Rs. 4568.41 crore in 2001-02. It expanded at a CAGR of 10.91 per cent. Commission expenses of LIC increased from Rs. 4519.31 crore in 2001-02 to Rs. 15118.14 crore in 2014-15. Commission expenses of LIC grew at a CAGR of 9.01 per cent. Commission expenses of private insurers increased from Rs. 49.09 crore in 2001-02 to Rs. 4342.54 crore in 2014-15. Private insurers’ commission expenses grew at a CAGR of 37.74 per cent.

Similarly, total operating expense of life insurance sector was increased from 4679.75 crore in 2001-02 to 32942.30 crore in 2010-11, but it was declined to 29674.59 crore in 2011-12 and increased thereafter to 36861.59 crore in 2014-15. Operating expenses of life insurance industry expanded at a CAGR of 15.88 per cent. Operating expenses of LIC increased from Rs. 4260.39 crore in 2001-02 to Rs. 22395.45 crore in 2014-15. Operating expenses of LIC grew at a CAGR of 12.58 per cent. Operating expenses of private insurers increased from Rs. 419.36 crore in 2001-02 to Rs. 14466.14 crore in 2014-15. Operating expenses of private insurers expanded at a CAGR of 28.78 per cent.

Table 3.5: Profitability of Life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Profit after tax</th>
<th>Investment income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private</td>
</tr>
<tr>
<td>2001-02</td>
<td>821.79</td>
<td>227.81</td>
</tr>
<tr>
<td>2002-03</td>
<td>9761.80</td>
<td>26038.98</td>
</tr>
</tbody>
</table>
Profitability of insurance industry has not been showing any consistency during the period of study. Insurance industry has seen various ups and downs during last countable years. Profit after tax and investment income has taken as measure of profitability for life insurance business in India. Profit after tax of life insurers reported an increase at the end of 2002 & 2003 and reflected negative results for seven consecutive years, but it again started gaining during 2011 to 2015. Profit after tax of LIC has reported profit for all years under study while private insurers has reported profit from 2010-11 onwards.

The investment income of life insurers was increased from Rs. 23869.11 crore to Rs. 246765.12 crore in 2014-15. In case of LIC, investment income was Rs. 23857.37 crore in 2001-02 which increased to Rs. 168063.58 crores in 2014-15.

### Table 3.6: Equity Share Capital of Life Insurance Companies in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>5.00</td>
<td>1664.00</td>
<td>1669</td>
</tr>
<tr>
<td>2002-03</td>
<td>5.00</td>
<td>2229.13</td>
<td>2234.13</td>
</tr>
<tr>
<td>2003-04</td>
<td>5.00</td>
<td>3238.71</td>
<td>3243.71</td>
</tr>
<tr>
<td>2004-05</td>
<td>5.00</td>
<td>4347.81</td>
<td>4352.81</td>
</tr>
<tr>
<td>2005-06</td>
<td>5.00</td>
<td>5887.06</td>
<td>5892.06</td>
</tr>
<tr>
<td>2006-07</td>
<td>5.00</td>
<td>8119.41</td>
<td>8124.41</td>
</tr>
<tr>
<td>2007-08</td>
<td>5.00</td>
<td>12291.42</td>
<td>12296.42</td>
</tr>
<tr>
<td>2008-09</td>
<td>5.00</td>
<td>18249.77</td>
<td>18254.77</td>
</tr>
<tr>
<td>2009-10</td>
<td>5.00</td>
<td>21015.00</td>
<td>21020</td>
</tr>
<tr>
<td>2010-11</td>
<td>5.00</td>
<td>23656.85</td>
<td>23661.85</td>
</tr>
<tr>
<td>2011-12</td>
<td>100.00</td>
<td>24831.92</td>
<td>24832.92</td>
</tr>
<tr>
<td>2012-13</td>
<td>100.00</td>
<td>25418.72</td>
<td>25419.72</td>
</tr>
<tr>
<td>2013-14</td>
<td>100.00</td>
<td>25838.51</td>
<td>25839.51</td>
</tr>
<tr>
<td>2014-15</td>
<td>100.00</td>
<td>26144.14</td>
<td>26145.14</td>
</tr>
</tbody>
</table>

**CAGR** 23.86% 21.74% 21.75%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Total paid up capital of life insurance companies was Rs. 26244.14 crore in 2014-15 which was Rs. 1669.00 crore in 2001-02. Total paid up capital of life insurance companies grew at a CAGR of 21.75 per cent. Paid up capital of LIC has Rs. 100.00 crore in 2014-15 which was Rs. 5.00 crore in 2001-02. Total paid up capital of LIC expanded at a CAGR of 23.86 per cent. Paid up capital of private life insurers was...
Rs. 26144.14 crore in 2014-15 which was Rs. 1664.00 crore in 2001-02. Total paid up capital of private life insurance companies increased at a CAGR of 21.74 per cent.

Table 3.7: Number of Life Insurance Offices in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>2190</td>
<td>116</td>
<td>2306</td>
</tr>
<tr>
<td>2002-03</td>
<td>2191</td>
<td>254</td>
<td>2445</td>
</tr>
<tr>
<td>2003-04</td>
<td>2196</td>
<td>416</td>
<td>2612</td>
</tr>
<tr>
<td>2004-05</td>
<td>2197</td>
<td>804</td>
<td>3001</td>
</tr>
<tr>
<td>2005-06</td>
<td>2220</td>
<td>1645</td>
<td>3865</td>
</tr>
<tr>
<td>2006-07</td>
<td>2301</td>
<td>3072</td>
<td>5373</td>
</tr>
<tr>
<td>2007-08</td>
<td>2522</td>
<td>6391</td>
<td>8913</td>
</tr>
<tr>
<td>2008-09</td>
<td>3030</td>
<td>8785</td>
<td>11815</td>
</tr>
<tr>
<td>2009-10</td>
<td>3250</td>
<td>8768</td>
<td>12018</td>
</tr>
<tr>
<td>2010-11</td>
<td>3371</td>
<td>8175</td>
<td>11546</td>
</tr>
<tr>
<td>2011-12</td>
<td>3455</td>
<td>7712</td>
<td>11167</td>
</tr>
<tr>
<td>2012-13</td>
<td>3526</td>
<td>6759</td>
<td>10285</td>
</tr>
<tr>
<td>2013-14</td>
<td>4839</td>
<td>6193</td>
<td>11032</td>
</tr>
<tr>
<td>2014-15</td>
<td>4877</td>
<td>6156</td>
<td>11033</td>
</tr>
</tbody>
</table>

CAGR 5.89% 32.80% 11.83%
Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Number of life insurance offices had increased from 2001-02 to 2009-10 and decreased thereafter till 2012-13. The decreasing trend of number of life offices reverted in 2013-14 and 2014-15. Number of life insurance offices opened by insurance sector increased at a CAGR of 11.83 per cent. Number of life insurance offices opened by private sector had increased from 116 in 2001-02 to 8768 in 2009-10 and decreased thereafter in subsequent years. Number of life insurance offices opened by private insurance sector grew at a CAGR of 32.80 per cent. The number of life offices established by LIC had increased to 4877 in 2014-15 from 2190 in 2001-02. Number of life insurance offices opened by LIC expanded at a CAGR of 5.89 per cent.

Growth of Non-life Insurance Sector

Table 3.8: Non-Life Insurance Penetration and Density in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Penetration (Percentage)</th>
<th>Density(USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>0.67</td>
<td>3.0</td>
</tr>
<tr>
<td>2002-03</td>
<td>0.62</td>
<td>3.5</td>
</tr>
<tr>
<td>2003-04</td>
<td>0.64</td>
<td>4.0</td>
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<tr>
<td>2004-05</td>
<td>0.61</td>
<td>4.4</td>
</tr>
<tr>
<td>2005-06</td>
<td>0.60</td>
<td>5.2</td>
</tr>
<tr>
<td>2006-07</td>
<td>0.60</td>
<td>6.2</td>
</tr>
<tr>
<td>2007-08</td>
<td>0.60</td>
<td>6.2</td>
</tr>
<tr>
<td>2008-09</td>
<td>0.60</td>
<td>6.7</td>
</tr>
<tr>
<td>2009-10</td>
<td>0.71</td>
<td>8.7</td>
</tr>
<tr>
<td>2010-11</td>
<td>0.70</td>
<td>10</td>
</tr>
<tr>
<td>2011-12</td>
<td>0.78</td>
<td>10.5</td>
</tr>
<tr>
<td>2012-13</td>
<td>0.80</td>
<td>11.0</td>
</tr>
<tr>
<td>2013-14</td>
<td>0.70</td>
<td>11.0</td>
</tr>
</tbody>
</table>
Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.8 given above shows non-life insurance penetration and density in India from 2001-02 to 2013-14. Non life insurance penetration was saw some mix trend over 2001-02 to 2004-05 which was 0.67 per cent in 2001-02 and 0.61 per cent in 2004-05, then it became constant at 0.60 per cent during 2005-06 to 2008-09 and finally increasing 0.70 per cent in 2013-14. During the years from 2002 to 2014, non-life insurance penetration remained in the range of 0.60-0.80 per cent Non life insurance density has been continuously increasing from USD 3.0 in 2001-02 to USD 11.0 in 2013-14.

Table 3.9: Number of Non-Life Insurance Companies in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Non Life Public</th>
<th>Private</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>5*</td>
<td>8</td>
<td>13</td>
<td>1</td>
</tr>
<tr>
<td>2002-03</td>
<td>6*</td>
<td>8</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>2003-04</td>
<td>6*</td>
<td>8</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>2004-05</td>
<td>6*</td>
<td>8</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>2005-06</td>
<td>6*</td>
<td>9</td>
<td>15</td>
<td>1</td>
</tr>
<tr>
<td>2006-07</td>
<td>6*</td>
<td>11**</td>
<td>17</td>
<td>1</td>
</tr>
<tr>
<td>2007-08</td>
<td>6*</td>
<td>14**</td>
<td>20</td>
<td>1</td>
</tr>
<tr>
<td>2008-09</td>
<td>6*</td>
<td>15**</td>
<td>21</td>
<td>1</td>
</tr>
<tr>
<td>2009-10</td>
<td>6*</td>
<td>18**</td>
<td>24</td>
<td>1</td>
</tr>
<tr>
<td>2010-11</td>
<td>6*</td>
<td>18**</td>
<td>24</td>
<td>1</td>
</tr>
<tr>
<td>2011-12</td>
<td>6*</td>
<td>21**</td>
<td>27</td>
<td>1</td>
</tr>
<tr>
<td>2012-13</td>
<td>6*</td>
<td>21**</td>
<td>27</td>
<td>1</td>
</tr>
<tr>
<td>2013-14</td>
<td>6*</td>
<td>22**</td>
<td>28</td>
<td>1</td>
</tr>
<tr>
<td>2014-15</td>
<td>6*</td>
<td>22**</td>
<td>28</td>
<td>1</td>
</tr>
</tbody>
</table>

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

*Includes Specialised Insurance Companies

** Includes Standalone Health Insurance Companies

Table 3.9 given above shows total number of non life insurance companies and reinsurance companies operating in India from 2001-02 to 2014-15. As the table depicts, in 2013-14, there are 28 non-life insurance companies and GIC acts as a sole national reinsurer. Of the 28 non life insurance-companies, six are in public sector including two are specialized insurers namely Export Credit Guarantee Corporation of India Limited and Agriculture Insurance Company of India Limited, and twenty two in private sector including five standalone health insurance companies.

Table 3.10: Premium Underwritten by Non-Life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>11917.59</td>
<td>467.65</td>
<td>12385.24</td>
</tr>
<tr>
<td>2002-03</td>
<td>13520.44</td>
<td>1349.80</td>
<td>14870.24</td>
</tr>
<tr>
<td>2003-04</td>
<td>13337.08</td>
<td>2257.83</td>
<td>15594.91</td>
</tr>
<tr>
<td>2004-05</td>
<td>13972.96</td>
<td>3507.62</td>
<td>17480.58</td>
</tr>
<tr>
<td>2005-06</td>
<td>15976.44</td>
<td>5362.66</td>
<td>21339.10</td>
</tr>
<tr>
<td>2006-07</td>
<td>16258.90</td>
<td>8646.57</td>
<td>24905.47</td>
</tr>
<tr>
<td>2007-08</td>
<td>16831.84</td>
<td>10991.89</td>
<td>27823.73</td>
</tr>
<tr>
<td>2008-09</td>
<td>18030.74</td>
<td>12321.09</td>
<td>30351.83</td>
</tr>
<tr>
<td>2009-10</td>
<td>20643.45</td>
<td>13977.00</td>
<td>34620.45</td>
</tr>
<tr>
<td>2010-11</td>
<td>25151.85</td>
<td>17424.63</td>
<td>42576.48</td>
</tr>
<tr>
<td>2011-12</td>
<td>30560.74</td>
<td>22315.03</td>
<td>52875.77</td>
</tr>
</tbody>
</table>
2012-13  35022.12  27950.53  62972.65
2013-14  38599.71  32010.30  70610.01
2014-15  42549.48  35090.09  77639.57

CAGR  9.52%  36.13%  14.01%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.
Note: Specialized and Standalone Health Private Insurers are not included.

Table 3.10 given above shows the premium underwritten by non-life insurance companies in India. There is a steady increase in the total premium collection by the non-life insurance sector during the period. The total premium collection went to Rs. 77639.57 crore in 2014-15 from Rs. 12385.24 crore in 2001-02. Non-life insurance industry expanded at a CAGR of 14.01 per cent. Public sector non-life insurers recorded a premium income of Rs. 11917.59 crore in 2001-02 which was increased to Rs. 42549.48 crore in 2014-15. Public sector non-life insurer’s premium collection increased at a CAGR of 9.52 per cent. Private sector recorded a premium income of Rs. 467.65 crore in 2001-02 which was increased to Rs. 35090.09 crore in 2014-15. Private sector non-life insurance premium collection increased at a CAGR of 36.13 per cent.

Table 3.11: Number of New Policies Issued by Non-Life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2002-03</td>
<td>4.18</td>
<td>0.16</td>
<td>4.34</td>
</tr>
<tr>
<td>2003-04</td>
<td>4.44</td>
<td>0.31</td>
<td>4.75</td>
</tr>
<tr>
<td>2004-05</td>
<td>4.46</td>
<td>0.51</td>
<td>4.97</td>
</tr>
<tr>
<td>2005-06</td>
<td>4.39</td>
<td>0.89</td>
<td>5.28</td>
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<tr>
<td>2006-07</td>
<td>3.39</td>
<td>1.26</td>
<td>4.65</td>
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<tr>
<td>2007-08</td>
<td>3.85</td>
<td>1.87</td>
<td>5.72</td>
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<td>2008-09</td>
<td>4.51</td>
<td>2.19</td>
<td>6.70</td>
</tr>
<tr>
<td>2009-10</td>
<td>4.51</td>
<td>2.19</td>
<td>6.70</td>
</tr>
<tr>
<td>2010-11</td>
<td>4.34</td>
<td>2.40</td>
<td>6.74</td>
</tr>
<tr>
<td>2011-12</td>
<td>3.29</td>
<td>5.28</td>
<td>8.57</td>
</tr>
<tr>
<td>2012-13</td>
<td>6.89</td>
<td>3.80</td>
<td>10.69</td>
</tr>
<tr>
<td>2013-14</td>
<td>6.00</td>
<td>4.24</td>
<td>10.24</td>
</tr>
<tr>
<td>2014-15</td>
<td>6.78</td>
<td>5.05</td>
<td>11.83</td>
</tr>
</tbody>
</table>

CAGR  3.79%  30.41%  8.02%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.
Note: Specialized and Standalone Health Private Insurers are not included.

Number of new policies issued by non-life insurance sector has been increased throughout the study period. Number of new policies issued in non-life insurance sector increased from 4.34 crore in 2002-03 to 11.83 crore in 2014-15. New policies issue in non-life insurance sector increased at a CAGR of 8.02 per cent. Public sector non-life insurance companies issued 4.18 crore new policies in 2002-03 which increased to 6.78 crore in 2014-15. New policies issue by Public sector non-life insurance companies increased at a CAGR of 3.79 per cent. Number of new policies issued by private non-life insurers was increased from 0.16 crore in 2002-03 to 5.05 crore in 2014-15. New policies issue by private life insurers increased at a CAGR of 30.41 per cent.

Table 3.12: Expenses of Non-life Insurance Companies in India
(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Commission</th>
<th>Operating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private Total</td>
</tr>
<tr>
<td>2001-02</td>
<td>657.41</td>
<td>5.91</td>
</tr>
<tr>
<td>2002-03</td>
<td>935.70</td>
<td>42.55</td>
</tr>
<tr>
<td>2003-04</td>
<td>1092.28</td>
<td>1201.93</td>
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<td>1233.19</td>
<td>1461.33</td>
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<td>2005-06</td>
<td>1431.41</td>
<td>1825.69</td>
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<td>2006-07</td>
<td>1489.74</td>
<td>2075.71</td>
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<td>2007-08</td>
<td>1519.54</td>
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<td>2008-09</td>
<td>1670.86</td>
<td>2353.65</td>
</tr>
<tr>
<td>2009-10</td>
<td>1825.81</td>
<td>2502.71</td>
</tr>
<tr>
<td>2010-11</td>
<td>1943.34</td>
<td>2737.56</td>
</tr>
<tr>
<td>2011-12</td>
<td>2258.09</td>
<td>2917.69</td>
</tr>
<tr>
<td>2012-13</td>
<td>2505.47</td>
<td>2938.80</td>
</tr>
<tr>
<td>2013-14</td>
<td>2869.72</td>
<td>3127.43</td>
</tr>
<tr>
<td>2014-15</td>
<td>3105.11</td>
<td>3337.89</td>
</tr>
</tbody>
</table>

CAGR 11.73% 50.22% 15.30% 11.21% 30.82% 14.83%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Table 3.12 given above shows commission and operating expenses of non-life insurance sector in India. Total commission expense of non life insurance sector increased from Rs. 663.32 in 2001-02 to Rs. 4865.83 crore in 2014-15. Commission expenses of non life insurance industry increased at a CAGR of 15.30 per cent. Commission expenses of public sector non-life insurers increased from Rs. 657.41 crore in 2001-02 to Rs. 3105.11 crore in 2014-15. Commission expenses of public sector non-life insurers grew at a CAGR of 11.73 per cent. Commission expenses of private sector non-life insurers increased from Rs. 5.91 crore in 2001-02 to Rs. 1760.72 crore in 2014-15. Commission expenses of private sector non-life insurers expanded at a CAGR of 50.22 per cent.

Similarly, total operating expense of non life insurance sector increased from Rs. 2700.87 crore in 2001-02 to Rs. 18708 crore in 2014-15. Total Operating expenses of non-life insurance industry increased at a CAGR of 14.83 crore. Operating expenses of public sector non-life insurers increased from Rs. 2525.78 crore in 2001-02 to Rs. 11181 crore in 2014-15. Operating expenses of public sector non-life insurers expanded at a CAGR of 11.21 per cent. Operating expenses of private sector non-life insurers increased from Rs. 175.09 crore in 2001-02 to Rs. 7527 crore in 2014-15. Operating expenses of private sector non-life insurers grew at a CAGR of 30.82 per cent.

Table 3.13: Profitability of Non-Insurance Companies in India

(Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Profit after tax</th>
<th>Investment income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private Total</td>
</tr>
<tr>
<td>2001-02</td>
<td>-49.49</td>
<td>-61.77</td>
</tr>
<tr>
<td>2002-03</td>
<td>625.16</td>
<td>6.75</td>
</tr>
<tr>
<td>2003-04</td>
<td>1358.3267.04</td>
<td>1425.363818.20154.32</td>
</tr>
<tr>
<td>2004-05</td>
<td>1171.60121.90</td>
<td>1293.5</td>
</tr>
<tr>
<td>2005-06</td>
<td>1319.28154.38</td>
<td>1473.665610.63269.47</td>
</tr>
</tbody>
</table>
Profitability of insurance industry has not been showing any consistency during the period of study. Insurance industry has seen various ups and downs during last countable years. Table 3.13 given above shows profitability of non-life insurance sector in India. Profit after tax and investment income has taken as measure of profitability for non-life insurance business in India. Profitability of non-life insurance sector has reported negative results for 2 years out of 14 years. Profit after tax of public sector non-life insurance companies has reported loss for 2 years out of 14 years. While private sector non-life insurers have reported negative results for 5 years out of 14 years.

The investment income of non-life insurers was increased from Rs. 2255.95 crore in 2001-02 to Rs. 15656.03 crore in 2014-15. In case of public sector non-life insurers, investment income was Rs. 2188.48 crore in 2001-02 which increased to Rs. 10725.02 crore in 2014-15. In case of private non-life insurance industry, investment income was at Rs. 67.47 crore in 2001-02 which increased to Rs. 4931.01 crores in 2014-15.

Table 3.14: Equity Share Capital of Non-Life Insurance Companies in India (Amount in crore)

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>400</td>
<td>726.50</td>
<td>1126.50</td>
</tr>
<tr>
<td>2002-03</td>
<td>400</td>
<td>883.00</td>
<td>1283.00</td>
</tr>
<tr>
<td>2003-04</td>
<td>400</td>
<td>1048.96</td>
<td>1448.96</td>
</tr>
<tr>
<td>2004-05</td>
<td>450</td>
<td>1048.96</td>
<td>1498.96</td>
</tr>
<tr>
<td>2005-06</td>
<td>500</td>
<td>1279.01</td>
<td>1779.01</td>
</tr>
<tr>
<td>2006-07</td>
<td>550</td>
<td>1400.87</td>
<td>2150.87</td>
</tr>
<tr>
<td>2007-08</td>
<td>550</td>
<td>1801.70</td>
<td>2351.70</td>
</tr>
<tr>
<td>2008-09</td>
<td>550</td>
<td>2353.23</td>
<td>2903.23</td>
</tr>
<tr>
<td>2009-10</td>
<td>550</td>
<td>3160.04</td>
<td>3710.04</td>
</tr>
<tr>
<td>2010-11</td>
<td>550</td>
<td>3955.70</td>
<td>4505.70</td>
</tr>
<tr>
<td>2011-12</td>
<td>550</td>
<td>4860.68</td>
<td>5410.68</td>
</tr>
<tr>
<td>2012-13</td>
<td>600</td>
<td>5974.72</td>
<td>6574.72</td>
</tr>
<tr>
<td>2013-14</td>
<td>600</td>
<td>6226.37</td>
<td>6826.37</td>
</tr>
<tr>
<td>2014-15</td>
<td>650</td>
<td>6972</td>
<td>7622</td>
</tr>
</tbody>
</table>

CAGR 3.53% 17.53% 14.63%

Total paid up capital of non-life insurance companies was Rs. 7622 crore in 2014-15 which was Rs. 1126.50 crore in 2001-02. Total paid up capital of non-life insurance companies increased at a CAGR of 14.63 per cent. Paid up capital of public sector non-life insurance companies was Rs. 650 crore in 2014-15 which was Rs.
400.00 crore in 2001-02. Total paid up capital of public sector non-life insurance companies expanded at a CAGR of 3.53 per cent. Paid up capital of private non-life insurers was Rs. 6972 crore in 2014-15 which is less than that of Rs. 726.50 crore in 2001-02. Total paid up capital of private life insurance companies grew at a CAGR of 17.53 per cent.

3.15: Incurred Claim Ratio of Non-Life Insurance Companies in India

<table>
<thead>
<tr>
<th>Years</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>90.19</td>
<td>23.03</td>
<td>88.81</td>
</tr>
<tr>
<td>2002-03</td>
<td>79.80</td>
<td>52.06</td>
<td>78.27</td>
</tr>
<tr>
<td>2003-04</td>
<td>79.91</td>
<td>50.97</td>
<td>77.20</td>
</tr>
<tr>
<td>2004-05</td>
<td>81.63</td>
<td>51.16</td>
<td>77.42</td>
</tr>
<tr>
<td>2005-06</td>
<td>89.94</td>
<td>54.47</td>
<td>83.03</td>
</tr>
<tr>
<td>2006-07</td>
<td>85.22</td>
<td>68.02</td>
<td>81.27</td>
</tr>
<tr>
<td>2007-08</td>
<td>90.43</td>
<td>72.21</td>
<td>84.88</td>
</tr>
<tr>
<td>2008-09</td>
<td>91.30</td>
<td>76.89</td>
<td>86.30</td>
</tr>
<tr>
<td>2009-10</td>
<td>88.27</td>
<td>80.30</td>
<td>85.50</td>
</tr>
<tr>
<td>2010-11</td>
<td>97.03</td>
<td>86.71</td>
<td>93.30</td>
</tr>
<tr>
<td>2011-12</td>
<td>89.22</td>
<td>88.22</td>
<td>88.85</td>
</tr>
<tr>
<td>2012-13</td>
<td>84.79</td>
<td>79.56</td>
<td>82.79</td>
</tr>
<tr>
<td>2013-14</td>
<td>83.20</td>
<td>79.58</td>
<td>81.74</td>
</tr>
<tr>
<td>2014-15</td>
<td>82.09</td>
<td>79.69</td>
<td>81.15</td>
</tr>
</tbody>
</table>

CAGR -0.67% 9.27% -0.64%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.
Note: Specialized and Standalone Health Private Insurers are not included.

The incurred claims ratio (net incurred claims to net earned premium) of the non-life insurance industry was 81.15 per cent during 2014-15 which is less than 88.81 per cent during 2001-02. Incurred claim ratio of non-life insurance companies exhibited a CAGR of -0.64 per cent. The incurred claims ratio for public sector insurers was 82.09 for the year 2014-15 which decreased from 2001-02 incurred claims ratio of 90.19, whereas for the private sector incurred claims ratio increased from 23.03 in 2001-02 to 79.69 in 2014-15. Incurred claim ratio of public sector non-life insurance companies declined at a CAGR of -0.67 per cent while incurred claim ratio of private sector non-life insurance companies grew at a CAGR of 9.27 per cent.

3.7 Conclusion

Over the past century, Indian insurance industry has undergone tremendous changes. It began as a fully private system with no restriction on foreign participation. After the independence, the industry went to the other extreme. It became a state-owned monopoly. In 1991, when rapid changes took place in many parts of the Indian economy, nothing happened to the institutional structure of insurance, it remained a monopoly. Only in 1999, a new legislation came into effect signalling a change in the insurance industry structure. There are numerous reasons that promoted the government to bring reforms in the insurance sector. Among other convincing reasons, it was also realized that India has vast potentials, which is waiting to be tapped, and this could only be achieved when sufficient competition is generated and it is exposed to the developments in the rest of the world. The Government of India liberalized the insurance sector which lifted the entry restrictions for private insurance players, allowing foreign players to enter into the Indian market and start their operations in India. Each foreign company needed to have a 26% equity capital to enter into the Indian insurance market. Many foreign companies have joined their hands with...
the Indian companies and started their operations in early 2001. Now, FDI limit has increased to 49%. It is gratifying to note that the new insurance companies have approached the business in a proper perspective. Both the life and non-life business is growing beyond the normal expectations. The actual growth is slightly beyond the forecasted growth of insurance sector. There is substantial increase in the total premium collection by insurance companies in both life and non-life sector after privatization. Insurance penetration and insurance density which have been marginal in both life and non-life sector seems improving. The share of private companies is continuously improving in both life and non-life sector but an interesting fact is that the rate of growth of the PSEs in the sector has not shown any trend of decline after privatization of the sector. The public sector in turn has redrawn its priorities, redesigned their market strategy and together the public sector and private sector have enlarged the market.

CHAPTER-3 FINANCIAL MARKETS IN INDIA
Financial markets in India comprise the money market Government securities market, capital market, insurance market, and the foreign exchange market. Recently, the derivatives market has also emerged. With banks having already been allowed to undertake insurance business, bane assurance market has also emerged in a big way. Till the early 1990s most of the financial markets were characterized by controls over the pricing of financial assets, restrictions on flows or transactions, barrier to entry, low liquidity and high transaction costs. These characteristics came in the way of development of the markets and allocative efficiency of resources channeled through them. From 1991 onward, financial market reforms have emphasized the strengthening of the price discovery process easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity.

Classification of Financial Markets2
Financial markets are classified in different ways, which are given below:

2. On the Basis of Maturity of the claims.
3. On the basis of Existing claim or New Claim.

A. On the Basis of Claim on financial Assets: The claims traded in a financial market may be for either a fixed amount or a residual amount. Based on claim on financial assets, financial markets are following two types: Equity market and Debt Market.

Equity Market3: Securities are conventionally divided into equities and debt securities. Financial markets in which equity instruments are traded are known as equity market. This market is also referred as the stock market. Two types of securities are traded in an equity market namely equity shares and preference shares. Preferred stock represents an equity claim that entitles the investor to receive a fixed amount of dividend. An important distinction between these two forms of equity securities lies in the degree to which they may participate in any distribution of earnings and capital and the priority given to each in the distribution of earnings.

Debt Market: Financial markets in which debt instruments are traded are referred as debt market. Debt instruments represent contracts whereby one party lends money to another on pre-determined terms and based on rate of interest to be paid by the borrower to the lender, the periodicity of such interest payment and the repayment of the principal amount borrowed. Debt securities are normally issued for a fixed term

1 Dr Benson and Dr. s. Mohan, — Financial Market and Financial services in India||, July 2012, p.1
2 Ibid.
and are redeemable by the issuer at the end of that term. Debt securities include debentures, bonds, deposits, notes or commercial papers. Debt market is also called fixed income market. Generally, debt securities and preferred stock are classified as part of the fixed income market. That sector of the stock market which does not include preferred stock is called the common stock market.

B. On the Basis of Maturity of the Claims:

Another way of classifying financial markets is on the basis of maturity/period of the claims. Based on this, financial markets are following two types: Money market and Capital market.

(a) Money Market: A financial market for short-term financial assets is called the money market. It is a market for dealing in monetary assets of short-term nature. The traditional cut off period for short term and long term claim is one year. Financial asset with a maturity of one year or less than one year is considered short term and therefore part of the money market. It is the central wholesale market for short-term debt securities, or for the temporary investment of large amount of short-term funds. Money market is a collective name given to various firms and institutions that deal with various grades of near-money. It includes trade bills, promissory notes and government securities. Money market instruments have the characteristics of quick liquidity and minimum transaction cost. The instruments in money markets are relatively risk-free and the relationship between the lender and borrower is largely impersonal. Borrowers in the money market are the central government, state governments, local bodies, traders, industrialists, farmers, exporters, importers and the public. The money market comprises several sub-markets, which are following:

(i) Call Money Market: Call money means the amount borrowed and lent by commercial banks for a very short period i.e., for one day to a maximum of two weeks. It is also called as inter bank call money market, because the participants in the call money market are mostly commercial banks. Call money market is the core of the Indian money market, which supply short-term funds. Call money market plays an important role in removing the routine fluctuations in the reserve position of the individual banks and improving the functioning of the banking system in the country.

(ii) Treasury Bill Market: For meeting its short-term financial commitments government issues these bills. The treasury bills market is a market, which deals in treasury bills issued by the Central Government for a short period of not more than 365 days. It is a permanent source of funds for the government. Regular treasury bills are sold to the banks and public, which are freely transferable.

(iii) Commercial Bill Market: Commercial bills are important device for providing short-term finance to the trade and industry. Commercial bill market deals in commercial bills issued by the firms engaged in business. These bills are generally issued for a period of three months. After acceptance, the bill becomes a legal document. Such bills can be transferred from one person to another by endorsement. The holder of the bill can discount the bills in a commercial bank for cash.

(iv) Certificate of Deposit Market: Certificate of deposit market deals with the certificate of deposits issued by commercial banks. A certificate of deposit is a document of title to a time deposit. The minimum amount of investment should not be less than Rs. one lakh and in the multiples of 1 lakh thereafter. The maturity period of CDs issued by banks should not be less than seven days and not more than one year. They are freely transferable by endorsement and delivery. Certificate of deposits provide greater flexibility to an investor in the deployment of their short-term funds.

(v) Commercial Paper Market: Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short-term basis. Commercial papers will be issued in
denominations of 5 lakh or multiples thereof. They are transferable by endorsement and delivery. Maturity period of commercial paper lies between 7 days and 365 days.

(vi) Collateral Loan Market: This market deals with loans, which are backed by collateral securities. Commercial banks provide short-term loan against government securities, share and debentures of the government etc.

Capital Market: Capital market is a market that specializes in trading long-term and relatively high-risk securities. A financial asset with a maturity of more than one year is part of the capital market. It is a market for long-term capital. The capital market provides long-term debt and equity finance for the government and the corporate sector. Capital market comprises two segments namely the new issue market and secondary market. The various constituents of capital market are viz. equity market, dept market, government securities market, mutual funds etc.

D. On the Basis of Domicile6: Another way of classifying financial markets is on the basis of domicile. Based on domicile way of classifying financial markets is on the basis of domicile. Based on domicile financial markets can be divided into two viz. International Market and Domestic Market.

6 Ibid.

(a) International Market 7: International market is the markets were the issuances of securities are offered simultaneously to investors of a number of globalization, deregulation and liberalization of financial markets the companies and the investors in any country seeking to raise funds are not limited to the financial assets issued in their domestic market.

(b) Domestic Market8: Domestic market is that part of a nation's internal market representing the mechanisms for issuing and trading securities of entities domiciled within that nation. It is a market where issuers who are domiciled in the country issue securities and where those securities are subsequently traded. It is otherwise called national or internal market. Domestic financial markets can be divided into different sub types like.

(i) Gilt-edged Market: It is a market for government and semi government securities, which carries fixed interest rates. Major players in the gilt-edged securities market in India are the Reserve Bank of India, State Bank of India, private and public sector commercial banks, co-operative banks and financial institutions.

(ii) Housing Finance Market: Housing finance market is characterized as a mortgage market, which facilitates the extent of credit, to the housing sector. National housing bank is an apex bank in the field of housing finance in India. It is a wholly owned subsidiary of the RBI. The primary responsibility of the bank is to promote and develop specialized housing finance institutions to mobilize resources and extent credit for house building.

(iii) Foreign Exchange Market: Foreign exchange market or Forex-market facilities the trading of foreign exchange. RBI is the regulatory authority for foreign exchange business in India. The foreign exchange market in India prior to the 1990s was characterized by strict regulations, restrictions on external transactions, barriers to entry, low liquidity and high transaction costs. Foreign exchange transactions were strictly regulated and controlled by the Foreign Exchange Regulations Act (FERA), 1973. With the rupee becoming fully convertible on all current account transactions in August 1994, the risk-bearing capacity of banks increased and foreign exchange trading volumes started rising.

8 Ibid.
recommendations to relax the regulations with a view to vitalizing the foreign exchange market. Foreign Exchange Regulation Act (FERA) was replaced by the Foreign Exchange Management Act (FEMA), 1999, in which the Reserve Bank of India delegated its powers to authorized dealers to release foreign exchange for a variety of purposes. Capital account transactions were also liberalized in a systematic manner.

(iv) Futures Market: Futures markets provide a way for business to manage price risks. A futures contract is an agreement that requires a party to the agreement to either buy or sell something at a designated future date at a predetermined price. The basic economic function of futures market is to provide an opportunity for market participants to hedge against the risk of adverse price movements. Buyers can obtain protection against rising prices and sellers can obtain protection against declining prices through futures contracts. Futures contract can be either commodity futures or financial futures. Commodity futures contract based on financial instruments or a financial index are known as financial futures. Financial futures can be classified as follows:

1. Stock index futures,
2. Interest rate futures,
3. Currency futures, and
4. Commodity futures etc.

Factors Affecting Financial Markets
1. Actions of Investors: Actions of individuals, institutions and mutual funds investors will instantly affect the prices of stocks, bonds, and futures in the securities market.
2. Business Conditions: Business conditions also affect the financial market. Profits earned volume of sales and even the time of year all will determine how much an investor wants to invest in stock.
3. Government Actions: The government makes all kinds of decisions that affect both how much an individual stock may be worth (new regulations on a business) and what sort of instruments people want to buy. The government’s interest rates, tax rates, trade policy and budget deficits all have an impact on prices.
4. Economic Indicators: General trends that signal changes in the economy are watched closely by investors to predict what is going to happen next. Such indicators include the Gross National Product (GNP), the inflation rate, the budget deficit and the unemployment rate. These indicators point to changes in the way ordinary people spend their money and how the economy is likely to perform.
5. International Events: Events around the world, such as changed in currency values, trade barriers, wars, natural disasters, and changes in governments will affect the price of securities, which ultimately influence the amount of investment.

The capital market is represented by investment bankers, over the counter market, SEBI etc.

Primary Market

Capital market consists of primary and secondary market. Primary market is that part of the capital market that deals with the issuance of new securities. Primary market is otherwise called as New Issue Market (NIM). In

Ibid.
the primary market the securities are purchased directly from the issuer. This is the market for new long-term or permanent capital. In other words, the money raised from the primary market provides long-term capital to the companies.

Primary market is a market which accelerates the process of capital formation in a country’s economy. Primary market provides opportunity to corporate and the government to raise resources to meet their investment requirements and to discharge their obligations. The companies use these funds either for setting up of new businesses or to expand the existing ones. At the same time, the funds collected through the primary capital market, are also used for modernization of business. The securities are issued in the primary market either at face value, or at a discount or premium. Companies will issue the securities either in domestic market or in the international market through American Depository Receipt (ADR) or Global Depository Receipt (GDR) or External Commercial Borrowings (ECB) route.

Characteristics of Primary Market

Primary capital markets are those security market where the equity and debt securities of corporations are offered to the investors for the first time. Important features of primary market are the following.

1. Primary market is the market for new long term capital.
2. In a primary market, the securities are issued for the first time by the company to investors.
3. In primary market securities are issued b the company directly to the investors.
4. In primary market the company receives the money and issues new security certificates to the investors.
5. In primary market it is difficult to accurately gauge the investor demand for a new security until several days of trading have occurred.
6. Primary market does not include certain other sources of new long-term external finance, such as loans from commercial banks and other financial institutions.
7. Primary issues are used by companies for setting up new business for expanding or modernizing the existing business or for providing permanent working capital.

Kinds of Issues

There are different ways for offering new issues in the primary capital market. Primary issues made by Indian companies can be classified as follows:

1. Public Issue.
2. Rights Issue.
4. Private Placement.

Public and rights issues involve a detailed procedure whereas private placements or preferential issues and bonus issues are relatively simple.

Public Issue

This is one of the important and commonly used methods for issuing new issues in the primary capital market. When an existing company offers its shares in the primary market, it is called public issue. It involves direct sale of securities to the public for a fixed price. In this kind of issue, securities are offered to the new investors for becoming part of shareholders family of the issuer. If everybody can subscribe to the securities issued by a company, such an issue is termed as a public issue. In terms of the Companies Act of 1956, an issue becomes public if it is allotted to more than 50 persons. SEBI defined public issue as—an invitation by a company to public to subscribe to the securities offered through a prospectus[]. Public issue can be further classified into two:

1. Initial Public Offer (IPO).
2. Further Public Offer (FPO).
Initial Public Offer (IPO)

An IPO is referred simply an offering or flotation of issue of shares to the public for the first time. Initial Public Offer is the selling of securities to

the public in the primary market. When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an Initial Public Offer (IPO).

The sale of securities can either be through book building or through normal public issue. IPOs are made by companies going through a transitory growth period or by privately owned companies looking to become publicly traded. IPO paves the way for listing and trading of the issuer’s securities in the stock exchanges. Initial public offering can be risky investment. For the individual investor, it is tough to predict the value of the shares on its initial day of trading and in the near future since there is often little historical data with which to analyze the company.

Further Public Offer (FPO)

When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public it if called FPO Further Public Offer (FPO) is otherwise called as Follow on Offer.

Rights Issue

When a listed company which proposes to issue fresh securities to its existing shareholders existing as on a particular dated fixed by the issuer (i.e. record date), it is called as rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date. The route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.

Bonus Issue

When an issuer makes an issue of shares to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued to the existing shareholders out of company’s free reserves or share premium account in a particular ratio to the number of securities held on a record date.

Private Placement

When a company offers its shares to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Often a combination of public issue and private placement can be used by the companies for the issue of securities in the primary market. Privately placed securities are often not publicly tradable and may only be bought and sold by sophisticated qualified investors. As a result, the secondary market is not liquid as in the case of a private issue. There are SEBI guidelines, which regulate the private placement of securities by a company.

Private placement is the fastest way for a company to raise equity capital. Private placement can of two types viz. preferential allotment and qualified institutional placement.

Issue of shares in the Primary Market

In India, the primary market is governed mainly by the provisions of The Companies Act, 2013, which deals with issues, listing and allotment of various types of securities. The Securities and Exchange Board of India (SEBI) protect the interests of investors in securities, promote the development of securities markets as well as regulate them.
SEBI issued the guidelines on primary issue of securities under Section 11 of the Securities and Exchange Board of India Act of 1992. In addition to the specific functions under the SEBI Act, the functions vested in the government as per Securities Contracts Regulations Act (SCRA) of 1956 have also been delegated to the SEBI. The SEBI now enjoy full powers to regulate the new issue market. Disclosure and Investor Protection Guidelines of SEBI (2000) deals with public issue, offer for sale and the rights issue by listed and unlisted companies. SEBI framed its DIP guidelines in 1992. SEBI (Disclosure and investor protection) guidelines 2000 are in short called DIP guidelines. The SEBI guidelines shall be applicable to all public issues by listed and unlisted companies, all offers for sale and rights issues by listed companies whose equity share capital is listed, except in case of rights issues where the aggregate value of securities offered does not exceed Rs 50 lakh. Since 1992, in order to streamline the public issue process by the Indian companies, SEBI has been issuing clarifications and amendments to these guidelines as and when required.

Prospectus

A prospectus is an invitation to the public to subscribe to the shares and debentures offered by a company. A public company can issue shares and debentures through a prospectus. As per Section 2(70) of The Companies Act, 2013 a prospectus means 'any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate'. Prospectus is a document that must accompany the application forms of all public issues of shares and debentures. Every prospectus has to comply with the requirements of The Companies Act, 2013 (Section 26 to 30). A prospectus is a legal document that institutions and businesses use to describe the securities they are offering for participants and buyers. If any prospectus is issued in contravention of Section 26 to 30 the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend up to five thousand rupees.

Typically, a prospectus contains the terms and conditions of the issue, along with the specific feature of the security, the purpose for which the issue is made, the company's track record, the risk inherent in the project for which the capital is being raised and so on.

Red Herring Prospectus (Section 32 of The Companies Act, 2013)

It is a draft prospectus, which is used in book building issues. A prospectus which does not have details of either price or number of shares being offered or the amount of issue is called red herring prospectus. It contains all disclosures except the price and the number of shares offered. Red herring prospectus is used for testing the market reaction to the proposed issue. Only on completion of the bidding process, the details of the final price are included in the offer document. The document filed thereafter with the Registrar of Company is called a prospectus.

Abridged Prospectus

According to Section 26 of The Companies Act, 2013, abridged prospectus means a memorandum containing the salient features of fee prospectus. The lead merchant banker shall ensure that a copy of the abridged prospectus containing the salient features of the prospectus accompanies every application form distributed by the issuer company or anyone else. The application form may be stapled to form part of the abridged prospectus. Alternatively, it may be a perforated part of the abridged prospectus. The abridged prospectus shall not contain matters, which are extraneous to the contents of the prospectus. Enough space shall be provided in the application form to enable the investors to file in various details like name, address etc. There are exceptions to Section 26 The Companies Act, 2013, which are given below:

1. Where the offer is made in connection with the bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures.
2. Where me snares or debentures are not differed to the public.

3. Where the offer is made only to the existing members or debenture holders of the company with or without a right to renounce.

4. Where the shares and debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognized stock exchange.

Book Building

Book building is a process of price discovery mechanism used by corporate issuing securities. It is a mechanism used to discover the price of their securities. Book building is a common practice in developed countries and has recently been making inroads into emerging market as well, including India. As per the recommendations of Malegan Committee, SEBI introduced the option of book building in public issue in October 1995. The option of book building was initially available only to those companies when their proposed public issue exceeded Rs. 100 crore. With effect from November 1996, the minimum size of the issue has been removed and any company can make a public issue through the book building process. However, issue of securities to the public through a prospectus for 100 percent book building process shall be available to a company only if their issue of capital shall be Rs. 25 crore and above.

Book building is a price discovery mechanism based on the bids received at various prices from the investors, for which demand is assessed and then the prices of the securities are discovered. In the case of normal public issue, the price is known in advance to the investors and the demand is known at the close of the issue. In the case of public issue through book building, demand can be known at the end of everyday but price is known only at the close of issue. Book building works on the assumption that the underwriting syndicate estimates demand and takes the allocation on their books, before the sale to the investor who is a retail one.

Securities and Exchange Board of India defined Book building as "a process undertaken prior to filing of prospectus with the Registrar of Companies by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for which such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memorandum or offer document", the objective of book building is to find the highest market clearing price.

The issuer company shall have an option of either reserving the securities for firm allotment or issuing the securities through book building process. The issue of securities through book building process shall be separately identified as "placement portion category" in the prospectus. The securities available to the public shall be separately identified as "net offer to the public".

Stock Invest Scheme

'Stock invest', a legal and non-negotiable instrument like a cheque, is used to ensure that investors fund continue to earn interest till such time the allotment is made by companies and they should not make undue advantage at the cost of investors savings. Their money is not blocked while anticipating the primary market issue. The Department of Company Affairs of Government of India and RBI have recognized the 'stock invest' as on one of the instruments by which the application money for subscription to shares, debentures etc. may be paid.

Issue of Sweat Equity

Sweat equity means equity shares issued by the 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 or value additions. The SEBI (Issue of Sweat Equity) Regulations, 2002 have been framed and the main provisions laid down for issue of sweat equity are the following:
1. The issue of sweat equity shares is authorized by a special resolution passed by the company in the general meeting. The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

2. The sweat equity shares should be locked in for a period of three years.

3. The pricing of the sweat equity shares should be as per the formula prescribed for that of preferential allotment.

4. Not less than one year has elapsed at the date of the issue since the date on which the company was entitled to commence business.

5. The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

**Employees Stock Option Scheme**

Employee Stock Option Scheme (ESOS) means a scheme under which company grants option to its employees to apply for shares of the company at a predetermined price. It is a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company. Employee's stock option scheme is governed by SEBI (Employees stock option scheme and employees stock purchase scheme) Guidelines of 1999.

**Secondary Market**

Capital market is a place that provides facilities for buying and selling of financial assets such as shares and debentures. Capital market comprises both primary and secondary market. The market for newly issued securities is called primary market. Secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. The secondary market refers to the market where the securities issued in the primary market are traded. In secondary market, the investor purchases an asset from another investor rather than from the issuing company. In secondary market previously issued securities and instruments are only bought and sold and hence secondary market is otherwise called as aftermarket. Once a newly issued share is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock. The key distinction between a primary market and a secondary market is that in the primary market, the issuer of those securities receives money directly from the investors. Rather, the existing issue changes hands in the secondary market, and funds flow from the buyer of the asset to the seller. In the primary market, long term securities are offered to public for subscription for the purpose of raising capital or fund. Whereas in secondary market, the long term financial instruments which are used for raising capital are traded.

The primary as well as the secondary markets is dependent on each other and changes in one market affect changes in the other. Compared to primary market majority of the trading is done in the secondary market. More the number of companies make new issues in the primary market; the greater will be the volume of trade in secondary market. In the secondary market securities are sold by and transferred from one investor or speculate to another. For a general investor, the secondary market provides an efficient platform for trading of his securities. Since secondary market provides it efficient platform for trading in securities, it ensures high liquidity to the general investors. For the management of the company, secondary market serves as a monitoring and controlling conduit by facilitating value enhancing control activities and aggregating information through price discovery that guides management decisions.
Secondary market is vital to an efficient and modern capital market. The stock exchange along with a host of other intermediaries provides the necessary platform for trading in secondary market and for clearing and settlement. Secondary market comprises equity markets and the debt markets. Secondary market could be either auction or dealer market. While stock exchange is part of an auction market, Over-the-Counter (OTC) is a part of the dealer market. Only listed securities can be traded in secondary market.

Securities Dealt in the Secondary Market

Following are the main financial instruments which are dealt in the secondary market:

1. Equity Shares.
2. Preferred Stock/Preference shares.
4. Debentures.
5. Commercial papers.
6. Coupons.
7. Dated securities.


8. Treasury Bills.

Listing of Securities

Listing means formal admission of a security into a public trading system of a stock exchange. A security is said to be listed when they have been included in the official list of the stock exchange for the purpose of trading. The prime objective of admission to dealings on the stock exchange is to provide liquidity and marketability to securities and also to provide a mechanism for effective management of trading. The securities listed in stock exchanges may be of any public limited company, central or state government, quasi-government and other corporations or financial institutions. To make a security eligible to be listed in a stock exchange, the company shall be obligatory to fulfil all the listing requirements specified in the Companies Act of 1956. Besides the company is also compulsorily to discharge the listing norms issued by SEBI from time to time and such other conditions, requirements and norms that may in force from time to time and the bye-laws and regulations of the exchange to make the security eligible to be listed and for continuous listing on the exchange.

Acts and Regulations Governing Listing of Companies

A company intending to list its securities in stock exchange shall fulfil all the basic requirements of listing stated in The Companies Act, 2013 and the Securities Contracts (regulations) Act of 1956. The issuer company shall also comply with all the conditions of listing stated both by SEBI and the concerned stock exchange. The securities listed on the exchange at its discretion, as the stock exchange has the right to include, suspend or remove from the list the said securities at any time and for any reason, which it considers appropriate. The companies desire to list their securities shall comply with all the relevant provisions of listing stated in the following Acts, Rules, Regulations and Guidelines.

- Indian Companies Act, 2013.
• Securities Contracts (Regulations) Act, 1956.

• Securities Contracts (Regulations) Rule, 1957.

• SEBI Guidelines (Disclosure and Investor Protection), 2000.

• Rules, bye-laws and regulations of the stock exchange made by time to time.

Listing Agreement

The company should execute a listing agreement, in the prescribed form with the stock exchange, prior to approval of the listing application of the company. Listing agreement is of great importance and is executed under the common seal of the company. Under this agreement, the company must give an undertaking to the exchange that they will provide facilities for prompt transfer, registration, sub-division and consolidation of securities and giving proper notice of closure of transfer books and record dates.

The listing agreement specifies the terms and conditions of listing and the disclosures that shall be made by a company on a continuous basis to the exchange for dissemination of information to the market. Any addition or amendment to the provisions of the listing agreement, as may be prescribed by SEBI and the stock exchange shall become applicable to the company as if such addition or amendment was part of the listing agreement. In other words, for listing of securities, companies are called upon to keep the stock exchange fully informed of all corporate developments having a bearing on the market price of shares like dividend, rights, bonus shares etc.

Trading Permission

As per SEBI Guidelines, an issuer company should complete the formalities for trading at all the stock exchanges where the securities are to be listed within 7 working days of finalization of the basis of allotment.” A company should scrupulously adhere to the time limit specified in SEBI (Disclosure and investor Protection) Guideline 2000 for allotment of all securities and dispatch of allotment letters/share certificates/credit in depository accounts and refund orders and for obtaining the listing permissions of all the exchanges whose names are stated in its prospectus or offer document.

In the event of listing permission being denied to a company by any stock exchange where it had applied for listing of its securities, the company cannot proceed with the allotment of shares. However, the company may file an appeal before SEBI under Section 22 of the Securities Contracts (Regulation) Act, 1956.

Central Listing Authority

The Central Listing Authority (CLA) is set up to address the issue of multiple listing of the same security and to bring about uniformity in the due diligence exercise in scrutinizing all listing applications on any stock exchanges. SEBI or any authority constitutes the Central Listing Authority under the relevant law relating to listing or delisting and trading or suspension of trading in securities of companies on a stock exchange.

The Central Listing Authority is constituted by SEBI and consists of a President and not more than ten members, out of which at least four members are representatives of the stock exchanges. SEBI appoints the President and the members of central listing authority. Persons having integrity, outstanding ability and drawn from judiciary, lawyers, academicians and financial experts are generally appointed as members.

The functions of Central Listing Authority as enumerated in SEBI (Central Listing Authority) Regulations of 2003 include the following:

1. Processing the application submitted by any body corporate, mutual fund or collective investment scheme for the letter of recommendation to get listed at the stock exchange.

Before making an application for listing to any stock exchange, a body corporate, mutual fund or collective investment scheme should obtain a letter of recommendation for listing from the Central Listing Authority on an application made on that behalf.

2. Making recommendations as to listing conditions.
3. Any other functions that may be specified from time to time by the SEBI. Where the Central Listing Authority refuses to issue letter of recommendation in accordance with the procedure laid down in the Regulations, the aggrieved party may approach SEBI with in 10 days of receipt of such refusal and if satisfied, SEBI may direct Central Listing Authority to issue a letter of recommendation within 15 days of receipt of such representation.

If the exchange refuses listing to the body corporate, mutual fund or collective Investment scheme, it may prefer an appeal to the Securities Appellate Tribunal as provided in the Securities Contracts (Regulations) Act, 1956.

The provisions, guidelines, norms and procedures governing the listing or delisting and trading or suspension of trading in securities may be stipulated by the Central Listing Authority and should be incorporated in the bye-laws of the exchange and should be made applicable to the exchange.

Central Listing Authority should also set up a fund called the Central Listing Authority Fund for any processing fees charged and received by the authority

Delisting of Securities

Delisting indicates removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange. In the interest of orderly market in securities or in the interest of trade or in the public interest, the Governing Board or Managing Director or Relevant Authority has absolute discretion to impose restrictions on trading in any security admitted to dealings on the exchange. During the operation of such restrictions, no trading member shall, either on his own account or on account of his sub-brokers or clients, enter into any transaction in contravention of such restrictions. SEBI Guidelines (Delisting of Securities), 2003 deals with the delisting of companies securities.

A company may be allowed to get its securities de-listed from the exchange, provided the provisions, guidelines, norms and procedures governing the delisting and suspension of trading in securities that may be stipulated by the SEBI or Central Listing Authority are duly complied with. SEBI guidelines on delisting of securities from stock exchanges are applicable only in the following three situations.

1. Voluntary delisting of securities.
2. Compulsory delisting of securities.
3. Liquidation or Merger.

Voluntary Delisting of Securities: Any promoter or acquirer desirous of voluntarily delisting of securities of a company from all or some of the exchanges shall fulfil the following conditions under the provisions of the SEBI guidelines.

1. Prior approval of shareholders of the company by a special resolution passed at its general body meeting.
2. Make a public announcement in the manner as provided in the guidelines.
3. Make an application to the delisting exchange in the form specified by the exchange.
4. Comply with such other additional conditions as may be specified by the concerned stock exchanges from where securities are to be de-listed.
The SEBI guidelines (Delisting of Securities, 2003) provide the overall framework for voluntary delisting by a promoter or acquirer through a process referred to as "Reverse Book Building".

Under reverse book building process the promoter shall appoint trading members for placing bids on the online electronic system. Investors may approach trading members for placing offers on the online electronic system. The shareholders desirous of availing the exit opportunity shall deposit the shares offered with the trading members prior to placement of orders. Alternately, they may mark a pledge for the same to the trading member.

The offer price has a floor price, which is average of 26 weeks average of traded price quoted on the stock exchange where the shares of the company are most frequently traded preceding 26 weeks from the date the public announcement is made. There is no ceiling on the maximum price. For occasionally traded securities, the offer price is as per Regulation 20 (5) of SEBI (Substantial Acquisition and Takeover) Regulations.

The final offer price shall be determined as the price at which the maximum number of shares has been offered. The promoter or acquirer shall have the choice to accept the price. If the price is accepted, the acquirer shall be required to accept all offers up to and including the final price. If the quantity eligible for acquiring securities at the final price offered does not result in public-shareholding falling below the required level of public holding for continuous listing, the company shall remain listed. At the end of the book building period, the merchant banker to the book building exercise shall announce the final price and the acceptance (or not) of the price by the promoter/acquirer.

The stock exchanges shall provide the infrastructure facility for display of the price at the terminal of the trading members to enable the investors to access the price on the screen to bring transparency to the delisting process. The stock exchange shall also monitor the possibility of price manipulation and keep under special watch the securities for which announcement for delisting has been made.

Compulsory Delisting of Securities

Permanent removal of securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submissions or complying with various requirements set out in the listing agreement within the time frames prescribed. In connection with compulsory de-listing of securities the stock exchanges have to adopt the following criteria.


The stock exchanges may delist companies which have been suspended for a minimum period of six months for non-compliance with the listing agreement. The stock exchanges have to give adequate and wide public notice through newspapers and also give a show cause notice to the company. The exchange shall provide a period of 15 days within which representation may be made to the exchange by any person who may be aggrieved by the proposed delisting.

Where the securities of the company are delisted by an exchange, the promoter of the company should be liable to compensate the security holders of the company by paying them the fair value of the securities held by them and acquiring their securities, subject to their option to remain holders of the company.

Liquidation or Merger: If any issuer whose securities have been granted admission to dealings on the exchange, be placed in final provisional liquidation or is about to be merged into or amalgamated with another company, the Governing Board or Managing Director or Relevant Authority may withdraw the admission to dealings on the exchange granted to its securities. The Relevant Authority may accept such evidence as it deems sufficient as to such liquidation, merger or amalgamation. If the merger or amalgamation fails to take place or if any company placed in provisional liquidation be reinstated and an application be made by such company for readmission of its securities to dealings on the exchange, the
competent authority shall have the power of considering and of approving, refusing or deferring such application.

Re-admission to Dealings on the Exchange

The Governing Board or Managing Director or Relevant Authority may readmit to dealings on the exchange the security of a company whose admission to dealings had been previously withdrawn, on the fulfilment of conditions, norms, guidelines or requirements as may be prescribed by the Governing Board or Managing Director or Relevant Authority and or SEBI from time to time. At the expiration of the period of suspension, the Governing Board or Managing Director or Relevant Authority may reinstate the dealings in such security subject to such conditions, as it deems fit.

Advantages to Companies

- Listing of securities on a stock exchange offers many opportunities to the companies. Following are the important advantages of listing:
  - Listing enables companies to enjoy the confidence of the investing public.
  - It helps the company to raise future finance easily for financing new projects, expansions, diversifications and for acquisitions.
  - Listing increases a company's ability to raise capital through various other routes like preferential issue, qualified institutional placement, ADRs, GDRs, FCCBs etc.
  - Listing improves the image or status of the company and thus it provides value addition.
  - Listing raises a company's public profile with customers, suppliers, investors, financial institutions and the media. A listed company is typically covered in analyst reports and may also be included in one or more of indices of the stock exchanges.
  - Listing facilitates nation-wide trading facility for a company's securities.
  - It facilitates companies to ascertain the market value of their shares.
  - Listing provides price continuity for securities.
  - Listed companies enjoy certain confessional rates of income tax.

Advantages to the Investors

- Listing provides ready marketability of securities.
- It ensures considerable liquidity to the investors.
- Listing ensures continuous liquidity to the investors.
- Listing provides fair, efficient and transparent securities market to the investors.
- Listing of securities on stock exchanges improves investor's awareness and confidence on securities.
- Listing leads to better and timely disclosures and thus protects the interest of the investors.
- It also provides a mechanism for effective management of trading

Disadvantages of Listing

- Once the securities are listed, the company is obligatory to discharge various regulatory measures, bye-laws, circulars and other guidelines as may be prescribed by the stock exchange and SEBI from time to time.
• Listing involves huge expenditure to the company.
• Companies have to fulfill a number of formalities for listing of securities.
• Listed companies are required to submit and disclose vital information to the stock exchanges from time to time.

Classification of Listed Securities

Listed securities are classified into two categories:

1. Cleared securities, and
2. Non-cleared securities.

Cleared Securities: Securities traded on carry over or forward trading basis are called cleared securities. In these types of securities forward trading facility is allowed through the clearing house of the stock exchange.

Non-cleared Securities: Those shares which are traded on cash basis are called non-cleared securities. In these types of securities carry forward facility is not provided. These securities are not included in cleared list of the stock exchange. Non-cleared securities are called non-specified or cash securities or Group B shares.

Stock Broker

A broker is an agent of the investor. A stockbroker is a member of a recognized stock exchange who transacts in securities. Stockbrokers are not allowed to buy, sell, or deal in securities, unless they hold a certificate granted by SEBI. The stockbrokers and sub brokers regulations were issued by the SEBI through a notification in October 1992 and it had the prior approval of the Central Government. The Securities and Exchange Board of India (Stock brokers and sub brokers) Rules, 1992 defined a stockbroker simply as "a member of a recognized stock exchange" Therefore, a registered stockbroker is a member of at least one of the recognized Indian stock exchanges. The application of a stockbroker for grant of certificate is made through a stock exchange/s, of which he is a member. The stock exchange on receipt of application from a broker forwards it to the SEBI as early as possible i.e. not later than thirty days from the date of its receipt. SEBI considers it and on being satisfied that the stockbroker is eligible, it shall grant a certificate to the stockbroker and this will be intimated to the stock exchange.

Sub-Broker

The Securities and Exchange Board of India (Stock brokers and sub- brokers) Rules, 1992 defines a sub-broker as "any person, not being a member of a stock exchange, who acts on behalf of a stockbroker as an agent, or otherwise, to assist the investors in buying, selling, or dealing in securities through such a stockbroker". Based on this definition, the sub-broker is either a stockbroker's agent or an arranger for the investor. Thus, legally speaking, the stockbroker as a principal will be responsible directly to the investor for conduct of a sub-broker who acts as his or her agent. However, the market practice is entirely different from this legally defined relationship. No sub-broker is supposed to buy, sell, or deal in securities, without a certificate granted by the SEBI. However, majority of the sub-brokers in India are not registered with SEBI.

Types of Members in Stock Exchange

There are different types of members in a stock exchange, which are given below:

Brokers
Brokers are commission agents or floor agents, who act as intermediaries between buyers and sellers of securities. Brokers do not purchase or sell securities on their behalf. They bring together the buyers and sellers and help them in making a deal. Brokers charge a commission from both the parties for their service. Brokers are experts in estimating trends of price and can effectively advice their clients in getting a fruitful gain. Stockbrokers are not allowed to buy, sell, or deal in securities, unless they hold a certificate granted by SEBI.

Jobbers

Jobbers are also members of the stock exchange who do business only for themselves. Jobbers as members of the stock exchange, deal in shares and debentures as independent operators. A jobber is a market maker who gives two-way quotes for a security at any point of time, a lower quotation for buying and a higher quotation for selling of securities. The difference between the two prices is termed as jobber's profit. Jobbers cannot deal on behalf of public and are barred from taking commission. In India, there is no clear-cut distinction between jobbers and brokers. Here a member can act as both a broker and a jobber at the same time. Jobbers acted as market makers in the London Stock Exchange. In India jobbers are also called taravaniwalas.

Market Makers

Market maker is the one who gives two way quotes for a security at any point of time. Market maker provides liquidity to scrip. A market maker would offer to do transaction on either side as chosen by the counter party at the prices indicated by the market maker for the quantities offered. The market maker assumes the price risk, the liquidity risk and the time risk. Price risk means that the market maker may not be able to cover his position at the same or better price than the price at which he did the original transaction. Liquidity risk means that he may not be able to liquidate his purchase position and may have to take deliveries and vice versa. Time risk means that the market maker may have to hold the inventory for an unknown period of time and lose the interest on his investments.

Taravaniwala

They are special category of members of the Bombay Stock Exchange. The taravaniwala may be a jobber who specializes in stocks located at the same trading post. When a jobber gives two way quotes and does the transaction, the difference he gets between these two ways spread is called Tarvani and the trader is called Tarvanivala. They make transactions on their own behalf and may act as brokers on behalf of the public.

Badliwalas

Badliwalas are financiers in the stock exchange. They usually give fully secured loans to the buyers and sellers for a short term period, say two or three weeks. For granting credit facilities they charge a fee known as 'cantago' or 'undabadala' or 'seedhabadala'.

Classification of Buyers and Sellers in a Stock Exchange

The buyers and sellers in a stock exchange can be classified into two broad categories:

1. Investors.
2. Speculators.

Investors
The investors buy the securities with a view to invest their savings in profitable income earning securities. An investor is interested in safety of his investment. They generally retain the securities for a considerable length of time with the objective of earning profit. They are assured of a profit in cash.


Speculators

A speculator may buy securities in expectation of an immediate rise in price of the securities. Speculation refers to the buying and selling of securities with a hope to sell them at a profit, in future. Those who engage in such activity are known as 'speculators'. Speculative transactions are made with the purpose of earning quick money. They do not retain their holdings for a long period. They buy the securities with the aim of selling them and not to retain them. They are interested only in price difference. They are not genuine investors.

If the expectation of speculator comes true, he sells the securities for a higher price and makes a profit. Similarly, a speculator may expect a price to fall and sell securities at the current high price to buy again when prices decline. He will make a profit if prices decline as expected. In reality, there is no pure speculator or an investor. Each investor is a speculator to some extent. Similarly, every speculator is an investor, to some other extent. Hence, the difference between the two is a matter of degree only.

Types of Speculators

There are four types of speculators who are active on the stock exchanges in India. They are known as Bull, Bear, Stag, and Lame Duck. These names have been derived from the animal world to bring out the nature and working of speculators. Bull and bear are the two classic market types used to characterize the general direction of the market.

Bull

Bull is a speculator who expects a rise in prices of securities in the future. In anticipation of price rise, he makes purchases of shares and other securities with the intention to sell at higher prices in future. He makes money when the share prices are rising. The speculator is called bull because the behaviour of the speculator is very much similar to a bull. A bull tends to throw his sufferer; up in the air. The bull speculator stimulates the price to rise, lie is an optimistic speculator. A bull also called as Tejiwala.

A bull market indicates generally rising stock prices high economic growth and strong investor confidence in the economy. The bull market tends to be associated with rising investor confidence and expectations of further capital gains. A key to successful investing during a bull market is to take advantage of the rising prices. When the prices of shares rise, it is called a bullish trend.

Bear

A bear market is a market condition that occurs when the prices of shares decline or are about to decline. A bear is a speculator who expects a fall in the prices of shares in future and sells securities at present with a view to purchase them at lower prices in future. A bear does not have securities at present but sells them at higher prices in anticipation that he will supply them by purchasing at lower prices in future. A bear speculator tends to force down the price of securities. A bear is a pessimistic speculator. If an investor is bearish they are referred to as bear because they believe a particular company, industry, sector or market in general is going to go down. A bear is also known as a Mandiwala.

A bear market indicates falling stock prices, bad economic news, and low investor confidence in the economy. The economy goes into recession coupled with a rise in unemployment and inflation. However, if the period of declining prices is not long and is immediately followed by a period where stock prices are on the increase, the trend is no longer considered as a bear market but labelled, in financial terms, as a 'correction'. Trading in a bear market is extremely difficult and risky for shareholders.
Stag

A stag is a cautious speculator in the stock exchange. A stag is an investor who neither buys nor sells but applies for subscription to the new issues, expecting that he can sell them at a premium. Stag is an investor who buys the shares in the primary market from public issue in anticipation of rise in prices on the listing of the shares on stock exchange. He selects those companies whose shares are in more demand and are likely to carry a premium. He is also called as 'premium hunter'.

Lame Duck

When a bear speculator finds it difficult to fulfil his commitment, he is said to be struggling like a lame duck. A bear speculator contracts to sell securities at a later date. On the appointed time, he is not able to get the securities, as the holders are not willing to part with them. In such situations, he feels concerned. Moreover, the buyer is not willing to carry over the transactions.

Clearing and Settlement Systems

Until the early 1990s, the trading and settlement infrastructure of the Indian capital market was poor. Trading on all stock exchanges was through open outcry, settlement systems were paper-based, and market intermediaries were largely unregulated. By late 1990s the clearing and settlement mechanism in Indian secondary market has witnessed significant changes and several innovations. The notable changes include use of the state-of-art information technology, emergence of a clearing corporation to assume counterparty risk, shorter settlement cycle, dematerialization and electronic transfer of securities, fine-tuned risk management system etc. Trading +2 rolling settlement has now been introduced for all securities. The regulators have also prescribed elaborate margining and capital adequacy standards to secure market integrity and protect the interests of investors.

Stock exchange is an entity which facilitates a platform for trading in securities to its registered members called brokers. They transact business primarily on behalf of their clients or investors. Clearing and settlement activity constitutes the core part of the trading cycle. After the conformation of a security deal, the broker who is involved in the transaction issues a contract note to the investor which contains all the information about the transactions in detail, at the end of the trade day. In response to the contract note issued by broker, the investor has to settle his obligation by either paying money or deliver the shares.

The transactions in stock exchanges pass through three distinct phases, viz. Trading, Clearing. Settlement Financial market in India consist of Money Market, Government securities market, capital market, insurance market and foreign exchange market. The derivatives market has also emerged. Now a days Banks are also allowed to undertake insurance business . Till the early 1990s most of the financial markets were characterized by control over the financial assets, restrictions on flows or transactions, barriers to entry, low liquidity and high transaction costs. These characteristics came in the way of development of markets and allocative efficiency resources channeled through them. From 1991 financial market reforms have emphasized the strengthening of the price discovery process, easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity.

Classes if Buyers

The securities of a corporation must be marketed so that fund raising may be facilitated. There are various classes of security buyer? who purchase different types of securities. They may be classified as follows:

Institutional or Professional Buyers

They are familiar with the character of the securities they buy. These include banks, investment trusts, insurance companies, special investment buyers and others. These are in some way related to sellers of securities and are obviously a little cautious about taking risks.
Bankers

Savings banks invest funds in Government and semi-Government securities, whereas commercial banks invest in debentures, notes or any other securities. They do not invest in speculative securities, for several restrictions have been placed upon their methods of investment. The practice governing the relations between corporations and bankers is the designation of a particular banking house as the latter's fiscal agent. Through which all the offerings of the company are made. The fiscal agent, in return for this preferential treatment, assumes a certain moral responsibility to finance the corporation, both in good and bad times. Company officials favour this method rather than the method of competitive bidding because of the feeling of security for new finances and refunding which this relationship gives them. They know that they are ordinarily safe, and that the fiscal agent will take care of them to the limit of his ability. At times, they may sell bonds at better prices by "shopping around" among bankers; but the difference is small, and in bad weather, they have often to pay through the nose.

Investment Bankers

The primary distribution of securities is generally performed by the investment banker who is the middleman between the issuing corporation and the investors seeking a return on their investment. An adequate investment banking system is just as important to the health of the private enterprise economy as an essential cog in the whole machinery of national economy. Investment bankers may participate in the formation of capital for new and established corporations by different methods,

Outright Purchase and Sale of Securities Offered by Issuing Corporation. This outright purchase of securities is often known as underwriting. An investment banker's profit is the difference between the price he pays for the securities and the price for which he sells them, less the selling commission and other expenses. The purchase price is either negotiated with the issuing corporation or established by competitive bidding. An investment banker assures the issuing corporation a definite price upon signing the purchase contract or underwriting agreement, and bears the risk of distributing the securities to his clients for profit. By dealing through investment bankers, the corporation is relieved of the risk of discouraging buyers for the entire issue offered. Moreover, the highly specialized function of securities distribution is entrusted to a specialized agency like the investment banker.

Life Insurance Corporation

The Life Insurance Corporation is owned by policy-holders. They collect annual premiums on insurance contracts. The sum total of the reserves of life insurance contracts issued by the Life Insurance Corporation of India constitutes the source of funds available to the industry. The size of the funds which are constantly available for investment makes the Life Insurance Corporation an important factor in the securities investment market. The investments are obviously regulated by certain laws.

General Insurance Companies

They do not have a large investment element in their contracts to accelerate the expansion of their activities- Nevertheless, their assets, which are substantial, are mainly in the form of investments.

Other Institutions

These include universities, hospitals, charitable trusts and philanthropic organisations which have large amounts of funds which they have to invest for long periods of time.

Investors

Individual investors include buyers of securities who in-vest their own funds. They depend on investment income and do not want to incur any risk. They desire to conserve their capital and appreciate
it, if possible, and aspire to a regular income on it. Their interest lies in the marketability of securities, an assurance of a definite rate of income, and the safety of the principal. They assume the minimum risk. Such investors buy debentures and preferred stock. Securities are issued by the company having an established business with an efficient management, assured profits and a conservative distribution of profits to stockholders. If any of these characteristics are absent from a business, its securities are not entitled to investment ranking, because there is no guarantee to the investor that the income, on the basis of which he buys the stock or a bond, will be permanent.

Speculators

Speculators may be professional traders. They do not depend on investment income, but expect a substantial capital appreciation. They prefer to buy equity stock with a desire to benefit by trading on equity. A company whose securities they select need not have an established record. Investors desire to take advantage of growing market for the company's products. They do not mind accepting some losses even if their judgment goes wrong. They believe in capital appreciation and accept oscillations in the prices of securities. They prefer newly organised companies with good prospects. If they successfully analyse the investment potential of their securities, they stand to gain handsomely. However, if their analysis proves to be totally wrong, they suffer disastrously and take heavy losses for their errors of judgment. The characteristics of a speculative security are the exact opposite of an investment. If a company is new, or if the efficiency of its management is doubtful, or if it has not yet achieved profitable operations, or if, as happens in rare instances, it has made profits and has, by the manipulation of its accounts, segregated its large earnings from stockholders, or, finally, if it has paid out a large percentage of profits so that it has to suspend dividends when earnings decline, its stock must be recorded as speculative. The characteristic of speculation is the fact that its value depends upon circumstances which cannot be known because only the future can reveal them. An investment, on the other hand, contains no "ifs" or "provides" or "beliefs." Its value is founded upon certainty. The value of a speculative security is built upon the shifting sands of probabilities and suppositions.

The stocks and bonds of established companies, where success is certain, are purchased by investors; but speculative securities are bought by speculators. The investor will not buy a security whose value is doubtful. He demands the quality of safety in a stock or bond, before anything else. He must be reasonably certain that his principal is safe, that he can, at any time in the future, disregarding the occasional fluctuations in the market, sell his stocks or bonds at or near the price he paid for them. If this assurance of safety of principal and certainty of income can be given to him, he is satisfied with a moderate return.

The Public

If the securities of a new corporation cannot be sold to a banker in resale to the investors, they must be sold to the public. This is composed of persons of moderate or small means who are willing to buy the shares of new companies at low prices, trusting in the representatives of those who have stock to sell, that these stocks will pay large dividends and eventually increase in value. The buyer has usually no knowledge of finance. He does not understand the nature of an investment judgment. He has no skill in offsetting advantages against disadvantages. For him a security is either good or bad. There is no half-way point. Great care must, therefore, be exercised to give him only the most simple and favourable information concerning a stock. The public asks few questions except those on the standing of the officers and directors of a new company, for naturally does not want to be robbed of the amount of dividends which is promised to the stockholders.

Trader Buyers

Trader buyers dispose of securities on a retail scale. They correspond to floor traders on the stock exchange. Trader buyers purchase such securities as readily appeal to them. They include individuals whose tastes differ from one person to another. There is, therefore, a considerable fluidity in security.
purchase preferences so far as individual buyers are concerned. Few individuals act on simple reasoning. Others act on their own prejudices and are often reluctant to change their investment preference because of their unfamiliarity with the scrip.

General Investment Buyers

This is a group of general investment buyers, including typical individuals and business establishments. The individuals are typical because they have accumulated funds which they do not like to use as a basis for income. The list of securities for sale widens the market for all securities and such individuals are stock-minded and pay their attention more to market quotations than to any other considerations. Ordinarily, a sound, significant background must be created to inspire their confidence. General investment buyers also include business establishments which regard securities as corporate investment.

Promoters

Security may be sold by the promoter to his friends and relatives. If securities have a large sales potential, they may well be sold directly in the open market.

Employees

Corporations may encourage their employees to buy their stock on instalment basis under favourable conditions. The basic idea of selling stock to employees is, that of fostering proper interest in the well-being. Some managements have a real interest in the welfare of employees and wish them to share in the fortunes of the company. There are two ways of selling stock to employees. In the first case, employees are allowed to switch their holding, if they so desire, to realise a profit. In another case, the companies sell the employees a special issue whereby employees are prevented from switching their holdings and will have to offer them back to the company for re-purchase in case they wish to dispose of them. This method has been criticized on the ground that it violates an elementary principle of diversification of risks, for in a period of depression, the employee is likely to suffer both ways. There may be a depreciation in the value of his stock. At the same time, he may have to lose his job.

Customers

Customer ownership is a new device which is employed by public utilities and industrial companies. Customers are allied with their concern by making them shareholders. The idea of such involvement is to encourage the customers to buy the products of the company and to boost its sales. Customer owners have a property interest in the company, and are less likely to agitate for lower rates and severe restrictions on the quality of the product. The risk is that, if securities prove to be low grade ones, there is a possibility that they will lose both the consumers’ goodwill and as well as the investment market.

Existing Stockholders

The corporation may sell its securities to the existing stockholders. It does so particularly at the time of its expansion.

Business Corporation

Business corporations, which can spare large sums of money, invest funds in short-term securities. Some corporations have investments in securities of subsidiary or affiliated companies with a view to acquiring control. Often, they invest in the securities of their supplier or creditor companies, and investments are made by marketing the securities of related companies. The above groups of investors range from uninformed investors to expert investors. The latter know the merits of their investments, whereas the former may be ignorant about them. The public is often gullible and succumbs to the false promises and gimmicks of the issuing corporations. There is, therefore, a need for protective measures for innocent investors. If the issuing corporation is guilty of fraudulent misrepresentation or concealment of material facts from the investors, the investors have a right to sue it and recover the damage caused to them-
However, it is difficult to prove the false representations of the corporations, and investors can ill-afford to bear the expenses of litigation.

Intermediaries

It is possible for a reputed corporation to distribute directly its issue of securities. Although this is economical, there are several considerations which force it to present its securities in the market through intermediaries.

(i) A corporation may not be acquainted with the investment market and is likely to be duped in the process of selling its securities.
(ii) When a corporation issues its securities directly, investors may possibly feel that it lacks the support of institutional agencies, and cannot, therefore, be trusted.


(iii) The securities sold through reputed agencies attract investors easily. Established agencies may be able to sell securities to a class of purchasers who do not have any hope of getting a quick return. On the contrary, if the corporation were to sell directly to investors, the latter may hope for quick returns; and, if these hopes are belied, they may sell back the securities.

Derivatives Markets

Derivatives are innovations that have redefined the financial services industry and they have attained a very significant place in the capital markets. The primary objectives of all investors are to maximize their returns and minimize their risks. The Derivatives are contracts which originated from the need to minimize risk. The word ‘derivative‘ originated from mathematics and refers to a variable, which in turn has been derived from another variable. Derivatives are so called because they have no value of their own. Financial markets are, by nature, extremely volatile and hence the risk factor is an important concern of financial agents. To reduce this risk, the concept of derivatives was introduced. The term —Derivative— indicates that it has no independent value, i.e. its value is entirely —derived— from the value of an underlying asset. Values of derivatives are determined by the fluctuations in the underlying assets. Derivatives are an alternative to investing directly in assets without buying and holding to the asset itself. They also allow investments in underlying and risks which cannot be purchased directly. A derivatives is basically a bet.

Derivatives are specialized contracts which signify an agreement or an option to buy or sell the underlying asset up to a certain time in the in the future at a prearranged price. The contract also has a fixed expiry period mostly in the range of 3 to 12 months from the date of commencement of the contract. The value of the contract depends on the expiry period and also in the price of the underlying asset.

A derivative is defined as —a contract between a buyer and a seller entered into today regarding a transaction to be fulfilled at a future point in time. Derivative is defined in another way as —a contract embodied with a right and or an obligation to make an exchange of financial asset from one party to another party. The term Derivative has been defined in the securities Contracts (Regulations) Act of 1956. As per the Act derivative includes:

1. A security derived from a debt instrument share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security.
2. A contract which derives its value form the prices, or index of prices, of underlying securities.

• Derivatives are financial products.
• Derivative is derived from another financial instrument/contract called the underlying.
• Derivative derives its value from the underlying assets.

Development of Derivatives Markets in India26
Derivatives have had a long presence in India. The commodity derivative market has been functioning in India since the nineteenth century with organized trading in cotton through the establishment of Cotton Trade Association in 1857. Since then contracts on various other commodities have also been introduced. Indian securities markets have indeed been waiting for too long for derivatives trading to emerge. Derivative products initially emerged as hedging devices against fluctuations in commodity prices and commodity-linked derivatives remained the sole form of such products for almost three hundred years. While derivatives markets flourished in the developed world, Indian markets remain deprived for financial derivatives up to the beginning of this millennium. While the rest of the world progressed by leaps and bounds on the derivatives front, Indian markets lagged behind. Financial derivatives came to the spotlight in the post 1970 period due to the growing instability of the financial markets.

26 Dr. Benson Kunjukuju and Dr. S. Mohan, ―Financial Market and services in India,‖ July 2012, p. 224-226.

The first step towards introduction of derivatives trading in India was the promulgation for the Securities Laws (Amendment) Ordinance, 1995, which withdrew the prohibition on options in securities. The market for derivatives, however, did not take off, as there was no regulatory framework to govern trading of derivatives.
SEBI set up a 24 member committee under the Chairmanship of Dr. L.C. Gupta on November 18, 1996 to develop an appropriate regulation framework for derivations trading and to recommend a bye-law for Regulation and Control of Trading and Settlement of Derivatives Contracts in India. The committee submitted its report on March 17, 1998 prescribing necessary pre-conditions for introduction of derivatives trading in India. It recommended that derivatives should be declared as „securities‟ so that regulatory framework applicable to trading of securities could also apply to trading of derivatives. The Board of SEBI in its meeting held on May 11, 1998 accepted the recommendations of the Gupta committee and introduced derivatives trading in India with Stock Index Futures. SEBI also appointed another group in June 1998 under the Chairmanship of Prof. J.R. Varma, to recommend measures for risk containment, in derivatives market in India. The report, which was submitted in October 1998, worked out the-operational details of margining system, methodology for charging initial margins, broker net worth, deposit requirement and real-time monitoring requirements. However the Securities Contracts (Regulation) Act, 1956 (SCRA) needed amendment to include "derivatives" in the' definition of securities to enable SEBI to introduce trading in derivatives. Thus the Securities Contract Regulation Act was amended in December 1999 to include derivatives within the ambit of securities’ and the regulatory framework was developed for governing derivatives trading. The act also made it clear that derivatives shall be legal and valid only if such contracts are traded on a recognized stock exchange, thus —precluding-QTC derivatives; The ban imposed on trading in derivatives way back in 1969 under a notification issued by the Central Government has been revoked.

Thereafter, SEBI formulated the necessary regulations/bye-laws and intimated the same to stock exchanges in the year 2000, and derivative trading started in India at NSE in the same year and at BSE in the year 2001. Derivative products—were introduced in a phased manner starting "With Index Futures Contracts in June 2000. SEBI permitted the derivative segments of two stock "exchanges, NSE and BSE, and their clearing house/corporation to commence trading-and-settlement in approved derivatives contracts. The derivatives trading on NSE commenced with S&P CNX Nifty Index futures on June 12, 2000. The index futures and options contract on NSE are based on S&P CNX Trading and I settlement in derivative contracts is done in accordance with the rules, byelaws, and regulations of "the respective
exchanges and their clearing house/corporation and are duly approved by SEBI and notified in the official gazette. 
Index Options and Stock Options were introduced in June 2001 and July 2001 followed by Stock Futures in November 2001. Sectoral indices were permitted for derivatives trading in December 2002. Interest Rate Futures on notional bond and T-bill were introduced in June 2003. Exchange traded interest rate futures on notional bond priced off on a basket of Government Securities was permitted for trading in January 2004. Mini derivative (F&O) contract on Index (SENSEX and Nifty) were permitted by SEBI in December 2007. Longer tenure Index Options contracts and Volatility Index commenced in January 2008. Further, Bond Index was introduced in April 2008.
In addition to the above, during August 2008, SEBI Permitted Exchange traded Currency Derivatives. Foreign Institutional Investors (FIIs) are permitted to trade in all exchange traded derivative products. National Commodity & Derivatives Exchange Limited (NCDEX) started its operations in December 2003, to provide a platform for commodities trading.
In recent years, markets for financial derivatives have grown tremendously in terms of instruments available, their complexity and their turnover. In the class of equity derivatives, futures and options on stock indices have gained more popularity than on stocks, especially among institutional investors, who are major users of index-linked derivatives. Even small investors find these instruments useful due to the high correlation of popular indexes with various portfolios and ease of use. In terms of volume and turnover, NSE is the largest derivatives exchange in India. Currently, the derivatives contracts have a maximum of three-months expiration cycles. Three contracts are available for trading, with one month, 2 months and 3 months expiry.

Functions of Derivatives Markets27
1. They help in transferring risks from risk averse people to risk oriented people.
2. Derivatives help in the discovery of future as well as current prices.
3. An important incidental benefit that flows from derivatives trading is that it acts as catalyst for new entrepreneurial activity. Derivatives attracted many bright, creative, well-educated people with an entrepreneurial attitude. They often energize others to create new businesses, new products and new employment opportunities, the benefit of which are immense.
4. The underlying market witness higher trading volumes because of participation by more players who would not otherwise participate for lack of an arrangement of transfer risk.
5. They increase savings and investment in the long run.
6. In the absence of an organized derivatives market, speculators trade in the activities of various participants become extremely difficult in this kind of mixed market.

Types of Derivatives Markets28
There are two competing segments in the derivatives market, which are given below:
1. Exchange Trade Derivatives Market

27 Ibid.
28 Ibid.

2. Over the Counter Derivatives Market

Exchange Traded Derivatives Markets

Exchange traded derivatives (ETD) are those derivatives products that are via specialized derivatives exchanges or other exchanges. A derivatives exchange acts as an intermediary to all related transactions, and takes initial margin from both sides of the trade to act as a guarantee. Exchange traded derivatives are
standardized contracts traded on the stock exchange. In the Exchange Traded Derivatives Market (on-exchange) or Future Market, exchange acts as the main party and by trading of derivatives, risk is actually traded between two parties. One party who purchases future contract is said to go "long" and the person who sells the future contract is said to go "short". The holder of the "long" position owns the future contract and earns profit from it if the price of the underlying security goes up in the future. On the contrary, holder of the "short" position is in a profitable position if the price of the underlying security goes down, as he has already sold the future contract. Therefore, when a new future contract is introduced, the total position in the contract is zero as no one is holding that for short or long periods.

Over the Counter Derivative Markets

Privately negotiated derivative contracts are called over-the-counter (OTC) derivatives. Over-the-counter (OTC) derivatives are contracts that are traded directly between two parties, without going through an exchange or other intermediary. OTC derivatives are created by an agreement between two individual counterparties. OTC derivatives cover a range from highly standardized to tailor-made contracts with individualized terms regarding underlying, contract size, maturity and other features. Products such as swaps, forward rate agreements, and exotic options are usually traded in this way. Both exchange-traded and OTC derivative contracts offer many benefits, the former have rigid structures compared to others. The OTC derivative market is the largest market for derivatives, and is unregulated.

Most derivatives products are initially developed as OTC derivatives. Once a product matures, exchanges "industrialize" it, creating a liquid market for a standardized and refined form of the new derivatives product. The OTC and exchange-traded derivatives then coexist side by side. The number of OTC-traded derivatives is unlimited in principle as they are customized and new contracts are created continuously. Swaps, Options and Forward Contracts are traded in Over the Counter Derivatives Market or OTC market. The main participants of OTC market are the Investment Banks, Commercial Banks, Govt. Sponsored Enterprises and Hedge Funds. The investment banks markets the derivatives through traders to the clients like hedge funds and the rest.

Features of OTC Derivatives Markets29

The OTC derivatives market has the following features compared to exchange-trade derivatives:
1. There are no formal rules for risk and burden sharing.
2. There are no formal limits on individual positions, leverage or margining.
3. There are no formal rules or mechanisms for ensuring market stability and integrity and for safeguarding the collective interests of market participants.
4. The management of counter-party credit risk is decentralized and located within individual institutions.
5. The OTC contracts are generally not regulated by a regulatory authority and the exchange's self-regulatory organization.

Government Securities30

It is a tradable instrument issued by central government and state government. It acknowledges the government’s debt obligation. Such

29 Ibid
30 Ibid at p. 294.

securities are short term (less than one year) or long term (more than one Year)

According to Public Debt Act of 1994, government securities means a security created and issued by the government for raising a public loan or any other purpose as notified by the government.

Advantages of Government Securities31-
- Government Securities offer maximum safety. No default risk as the Government Securities carry sovereign guarantee for payment of interest and repayment of principal.
- Government Securities are available in a wide maturities from 91 days to as long as 30 years to suit the requirement of investors.
- Government securities provide ample liquidity to the investors. It can be easily sold in secondary market to meet cash requirement.
- The settlement system for trading in Government Securities, which is based on Delivery Versus Payment (DvP), is a very simple, safe and efficient system of settlement. The DvP mechanism ensures transfer of securities by the seller of securities simultaneously with transfer of funds from the buyer of the securities, mitigating the settlement risk.
- Lower volatility as compared to corporate bonds.

These are various type of securities dealt in financial market in India. The various law regulating the financial market is-
- The Companies Act 2013.
- Securities Contract Regulation Act
- Security Exchange Board of India Act,1992
- Government Securities Act 2006
- Reserve Bank of India Act, 1935.

Every person is eligible to invest in Government securities. The biggest investors of both central and state Government Securities are commercial banks.


Financial market in India plays an important role for development of country. Through Financial Market companies raises finance for its activities by issuance of prospectus. Only public company can raise finance from public. Till the early 1990s most of the financial markets were characterized by controls over the pricing of financial assets, restrictions on flows or transactions, barrier to entry, low liquidity and high transaction costs. These characteristics came in the way of development of the markets and allocative efficiently of resources channeled through them. From 1991 onward, financial market reforms have emphasized the strengthening of the price discovery process easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity. Free pricing of financial assets, greater transparency, regulatory and legal challenge, building of institutional infrastructure , improvement in trading, clearing and settlement practices.

The money market has witnessed the emergence of a number of new instruments such as commercial paper and certificate of deposit and derivative products including forward rate agreements and interest rate swaps. Repo operations, which were introduced in the early 1990s and later refined into a liquidity adjustment facility, allow the RBI to modulate liquidity and transmit interest rate signals to market on a daily basis.

The process of financial market development was buttressed by the evolution of an active Government securities market after the government borrowing programme was put through the auction process in 1992-93. The development of a market for Government paper enabled the RBI to modulate the monetization of the fiscal deficit.

The corporate debt market is not yet large to have a significant impact on systematic stability. The Indian financial system is predominated by Bank intermediation. Corporate in India have traditionally relied on borrowing from bank and financial institutions. Equity financing has also been used during periods of surging equity prices. The Corporate Bond markets, which was reasonably vibrant in mid eighties has shrunk with respect to its alternative sources of funding. The Lack of binding interest, low transparency and absence of pricing of spreads against the benchmark are some of the other
reasons. The opening up of capital account could see the growth of corporate bond markets as there are may be demand from foreign investors seeking exposure to high quality corporate debt.

The foreign exchange market deepened with the opening up of the economy and the institutions of a market based exchange rates regime in the early 1990s. Although there are occasional episodes of volatility in foreign exchange market, these are swiftly controlled by appropriate policy measures.

Financial instruments fall into two broad groups – (1) Direct instrument and (2) derivatives Instruments. Direct Instrument in Capital market includes the following:

1. Equity shares.
2. Preference shares
3. Debentures

The capital market consists of primary market and secondary market in which trading in shares and other debentures are done. In term of trading and settlement practices, risk management and infrastructure, capital market in India is now comparable to the developed markets. Although stock market have undergone a number of shocks and irregularities over the past decade, they have over time, developed sophisticated institutional mechanisms by harnessing modern technology. Even though the market design on the stock markets have made major progress, there are continuing concern about the speed and effectiveness with which fraudulent activities can be detected and focused.

India Financial Market
What is India Financial Market?
What does the India Financial market comprise of? It talks about the primary market, FDIs, alternative investment options, banking and insurance and the pension sectors, asset management segment as well. With all these elements in the India Financial market, it happens to be one of the oldest across the globe and is definitely the fastest growing and best among all the financial markets of the emerging economies.

The history of Indian capital markets spans back 200 years, around the end of the 18th century. It was at this time that India was under the rule of the East India Company. The capital market of India initially developed around Mumbai; with around 200 to 250 securities brokers participating in active trade during the second half of the 19th century.

Scope of the India Financial Market -
The financial market in India at present is more advanced than many other sectors as it became organized as early as the 19th century with the securities exchanges in Mumbai, Ahmedabad and Kolkata. In the early 1960s, the number of securities exchanges in India became eight - including Mumbai, Ahmedabad and Kolkata. Apart from these three exchanges, there was the Madras, Kanpur, Delhi, Bangalore and Pune exchanges as well. Today there are 23 regional securities exchanges in India.

The Indian stock markets till date have remained stagnant due to the rigid economic controls. It was only in 1991, after the liberalization process that the India securities market witnessed a flurry of IPOs serially. The market saw many new companies spanning across different industry segments and business began to flourish.

The launch of the NSE (National Stock Exchange) and the OTCEI (Over the Counter Exchange of India) in the mid 1990s helped in regulating a smooth and transparent form of securities trading.
The regulatory body for the Indian capital markets was the SEBI (Securities and Exchange Board of India). The capital markets in India experienced turbulence after which the SEBI came into prominence. The market loopholes had to be bridged by taking drastic measures.

Potential of the India Financial Market -
India Financial Market helps in promoting the savings of the economy - helping to adopt an effective channel to transmit various financial policies. The Indian financial sector is well-developed, competitive, efficient and integrated to face all shocks. In the India financial market there are various types of financial products whose prices are determined by the numerous buyers and sellers in the market. The other determinant factor of the prices of the financial products is the market forces of demand and supply. The various other types of Indian markets help in the functioning of the wide India financial sector.

Features of the Financial Market in India:
• India Financial Indices - BSE 30 Index, various sector indexes, stock quotes, Sensex charts, bond prices, foreign exchange, Rupee & Dollar Chart
• Indian Financial market news
• Stock News - Bombay Stock Exchange, BSE Sensex 30 index, S&P CNX-Nifty, company information, issues on market capitalization, corporate earning statements
• Fixed Income - Corporate Bond Prices, Corporate Debt details, Debt trading activities, Interest Rates, Money Market, Government Securities, Public Sector Debt, External Debt Service
• Foreign Investment - Foreign Debt Database composed by BIS, IMF, OECD,& World Bank, Investments in India & Abroad
• Global Equity Indexes - Dow Jones Global indexes, Morgan Stanley Equity Indexes
• Currency Indexes - FX & Gold Chart Plotter, J. P. Morgan Currency Indexes
• National and Global Market Relations
• Mutual Funds
• Insurance
• Loans
• Forex and Bullion

If an investor has a clear understanding of the India financial market, then formulating investing strategies and tips would be easier.

An Introduction to the Indian Stock Market

Mark Twain once divided the world into two kinds of people: those who have seen the famous Indian monument, the Taj Mahal, and those who haven't. The same could be said about investors. There are two kinds of investors: those who know about the investment opportunities in India and those who don't. India may look like a small dot to someone in the U.S., but upon closer inspection, you will find the same things you would expect from any promising market. Here we'll provide an overview of the Indian stock market and how interested investors can gain exposure. (For related reading, check out Fundamentals Of How India Makes Its Money.)

The BSE and NSE
Most of the trading in the Indian stock market takes place on its two stock exchanges: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE has been in existence since 1875. The NSE, on the other hand, was founded in 1992 and started trading in 1994. However, both exchanges follow the same trading mechanism, trading hours, settlement process, etc. At the last count, the BSE had about 4,700 listed firms, whereas the rival NSE had about 1,200. Out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization; the rest of the crowd consists of highly illiquid shares.

Almost all the significant firms of India are listed on both the exchanges. NSE enjoys a dominant share in spot trading, with about 70% of the market share, as of 2009, and almost a complete monopoly in derivatives trading, with about a 98% share in this market, also as of 2009. Both exchanges compete for the order flow that leads to reduced costs, market efficiency and innovation. The presence of arbitrageurs
keeps the prices on the two stock exchanges within a very tight range. (To learn more, see The Birth Of Stock Exchanges.)

Trading Mechanism
Trading at both the exchanges takes place through an open electronic limit order book, in which order matching is done by the trading computer. There are no market makers or specialists and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous. The advantage of an order driven market is that it brings more transparency, by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed.

All orders in the trading system need to be placed through brokers, many of which provide online trading facility to retail customers. Institutional investors can also take advantage of the direct market access (DMA) option, in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system. (For more, read Brokers And Online Trading: Accounts And Orders.)

Settlement Cycle and Trading Hours
Equity spot markets follow a T+2 rolling settlement. This means that any trade taking place on Monday, gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 am and 3:30 pm, Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk, by serving as a central counterparty.

Market Indexes
The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 45% of the index's free-float market capitalization. It was created in 1986 and provides time series data from April 1979, onward. Another index is the S&P CNX Nifty; it includes 50 shares listed on the NSE, which represent about 62% of its free-float market capitalization. It was created in 1996 and provides time series data from July 1990, onward. (To learn more about Indian stock exchanges please go to http://www.bseindia.com/ and http://www.nse-india.com/.)

Market Regulation
The overall responsibility of development, regulation and supervision of the stock market rests with the Securities & Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach. (For more insight, see http://www.sebi.gov.in/.)

Who Can Invest In India?
India started permitting outside investments only in the 1990s. Foreign investments are classified into two categories: foreign direct investment (FDI) and foreign portfolio investment (FPI). All investments in which an investor takes part in the day-to-day management and operations of the company, are treated as FDI, whereas investments in shares without any control over management and operations, are treated as FPI.

For making portfolio investment in India, one should be registered either as a foreign institutional investor (FII) or as one of the sub-accounts of one of the registered FIIs. Both registrations are granted by the market regulator, SEBI. Foreign institutional investors mainly consist of mutual funds, pension funds, endowments, sovereign wealth funds, insurance companies, banks, asset management companies etc. At present, India does not allow foreign individuals to invest directly into its stock market. However, high-net-worth individuals (those with a net worth of at least $US50 million) can be registered as sub-accounts of an FII.

Foreign institutional investors and their sub accounts can invest directly into any of the stocks listed on any of the stock exchanges. Most portfolio investments consist of investment in securities in the primary and secondary markets, including shares, debentures and warrants of companies listed or to be listed on a recognized stock exchange in India. FIIs can also invest in unlisted securities outside stock exchanges,
subject to approval of the price by the Reserve Bank of India. Finally, they can invest in units of mutual funds and derivatives traded on any stock exchange.

An FII registered as a debt-only FII can invest 100% of its investment into debt instruments. Other FIIs must invest a minimum of 70% of their investments in equity. The balance of 30% can be invested in debt. FIIs must use special non-resident rupee bank accounts, in order to move money in and out of India. The balances held in such an account can be fully repatriated. (For related reading, see Re-evaluating Emerging Markets.)

Restrictions/Investment Ceilings
The government of India prescribes the FDI limit and different ceilings have been prescribed for different sectors. Over a period of time, the government has been progressively increasing the ceilings. FDI ceilings mostly fall in the range of 26-100%.

By default, the maximum limit for portfolio investment in a particular listed firm, is decided by the FDI limit prescribed for the sector to which the firm belongs. However, there are two additional restrictions on portfolio investment. First, the aggregate limit of investment by all FIIs, inclusive of their sub-accounts in any particular firm, has been fixed at 24% of the paid-up capital. However, the same can be raised up to the sector cap, with the approval of the company’s boards and shareholders.

Secondly, investment by any single FII in any particular firm should not exceed 10% of the paid-up capital of the company. Regulations permit a separate 10% ceiling on investment for each of the sub-accounts of an FII, in any particular firm. However, in case of foreign corporations or individuals investing as a sub-account, the same ceiling is only 5%. Regulations also impose limits for investment in equity-based derivatives trading on stock exchanges. (For current restrictions and investment ceilings go to https://rbi.org.in/)

Investment Opportunities for Retail Foreign Investors
Foreign entities and individuals can gain exposure to Indian stocks through institutional investors. Many India-focused mutual funds are becoming popular among retail investors. Investments could also be made through some of the offshore instruments, like participatory notes (PNs) and depositary receipts, such as American depositary receipts (ADRs), global depositary receipts (GDRs), and exchange traded funds (ETFs) and exchange-traded notes (ETNs). (To learn about these investments, see 20 Investments You Should Know.)

As per Indian regulations, participatory notes representing underlying Indian stocks can be issued offshore by FIIs, only to regulated entities. However, even small investors can invest in American depositary receipts representing the underlying stocks of some of the well-known Indian firms, listed on the New York Stock Exchange and Nasdaq. ADRs are denominated in dollars and subject to the regulations of the U.S. Securities and Exchange Commission (SEC). Likewise, global depositary receipts are listed on European stock exchanges. However, many promising Indian firms are not yet using ADRs or GDRs to access offshore investors.

Retail investors also have the option of investing in ETFs and ETNs, based on Indian stocks. India ETFs mostly make investments in indexes made up of Indian stocks. Most of the stocks included in the index are the ones already listed on NYSE and Nasdaq. As of 2009, the two most prominent ETFs based on Indian stocks are the Wisdom-Tree India Earnings Fund (NYSE: EPI) and the PowerShares India Portfolio Fund (NYSE:PIN). The most prominent ETN is the MSCI India Index Exchange Traded Note (NYSE:INP). Both ETFs and ETNs provide good investment opportunity for outside investors.

The Bottom Line
Emerging markets like India, are fast becoming engines for future growth. Currently, only a very low percentage of the household savings of Indians are invested in the domestic stock market, but with GDP growing at 7-8% annually and a stable financial market, we might see more money joining the race. Maybe it’s the right time for outside investors to seriously think about joining the India bandwagon.

What’s the difference between primary and secondary capital markets?
A:
The difference between the primary capital market and the secondary capital market is that in the primary market, investors buy securities directly from the company issuing them, while in the secondary market, investors trade securities among themselves, and the company with the security being traded does usually not participate in the transaction.

The primary market
When a company publicly sells new stocks and bonds for the first time, it does so in the primary capital market. In many cases, this takes the form of an initial public offering (IPO). When investors purchase securities on the primary capital market, the company offering the securities has already hired an underwriting firm to review the offering and create a prospectus outlining the price and other details of the securities to be issued.

Companies issuing securities via the primary capital market hire investment bankers to obtain commitments from large institutional investors to purchase the securities when first offered. Small investors are not often able to purchase securities at this point, because the company and its investment bankers seek to sell all of the available securities in a short period of time to meet the required volume and must focus on marketing the sale to large investors who can buy more securities at once. Marketing the sale to investors can often include a "road show" or "dog and pony show," in which investment bankers and the company's leadership travel to meet with potential investors and convince them of the value of the security being issued.

The secondary market
The secondary market is where securities are traded after the company has sold all the stocks and bonds offered on the primary market. Markets such as the New York Stock Exchange (NYSE), London Stock Exchange or Nasdaq are secondary markets. On the secondary market, small investors have a better chance of buying or selling securities, because they are no longer excluded from IPOs due to the small amount of money they represent. Anyone can purchase securities on the secondary market as long as they are willing to pay the price for which the security is being traded.

On the secondary market, a broker typically purchases the securities on behalf of an investor. The price of the security fluctuates with the market, and the cost to the investor includes the commission paid to the broker. The volume of securities traded also varies from day to day, as demand for the security fluctuates. The price paid by the investor is no longer directly related to the initial price of the security as determined by the first issuance, and the company that issued the security is not a party to any sale between two investors, except in the case of a company stock buyback.

Over-the-Counter Exchange of India (OTCEI)
What is the 'Over-the-Counter Exchange of India (OTCEI)'
The over-the-counter exchange of India (OTCEI) is an electronic stock exchange based in India that consists of small- and medium-sized firms aiming to gain access to the capital markets like electronic exchanges in the U.S. such as the Nasdaq, there is no central place of exchange, and all trading occurs through electronic networks.

Next Up
1. OVER-THE-COUNTER - OTC
2. BRAZIL, RUSSIA, INDIA AND CHINA ...
3. OTC PINK
4. STOCK MARKET
5. BREAKING DOWN 'Over-the-Counter Exchange of India (OTCEI)'
The first electronic OTC stock exchange in India was established in 1990 to provide investors and companies with an additional way to trade and issue securities. This was the first exchange in India to introduce market makers, which are firms that hold shares in companies and facilitate the trading of securities by buying and selling from other participants.

Over-the-Counter Exchange of India: OTCEI and OTC Trading in U.S. Markets
In the U.S. and worldwide over-the-counter or OTC markets exist outside of formal exchanges. In the U.S. these include the New York Stock Exchange (NYSE), Toronto Stock Exchange or the NYSE MKT, formerly known as the American Stock Exchange (AMEX). In the U.S. OTC also refers to debt securities and other financial instruments, such as derivatives, which trade via a dealer network.

The OTC Markets Group operates some of the most popular OTC networks, including the OTCQX Best Market, the OTCQB Venture Market, and the Pink Open Market. While Nasdaq operates as a dealer network, Nasdaq stocks are generally not classified as OTC. The Nasdaq is considered a stock exchange.

Today, fewer differences exist among traditional exchanges and OTC networks, due to advances in technology that allow for improvements in electronic quotation and trading. These have facilitated higher liquidity and better information sharing. However, on a formal exchange, each party is exposed to offers by every other counterparty. In dealer networks, this may not be the case, given less transparency and less stringent regulation on these exchange.

Over-the-Counter Exchange of India: OTCEI and BRIC

India is part of the BRIC economic bloc that consists of Brazil, Russia, India and China (BRIC). BRIC refers to the notion that by 2050 China and India will become the world's dominant suppliers of manufactured goods and services, while Brazil and Russia will become similarly dominant as suppliers of raw materials. (BRIC now includes a fifth nation, South Africa.) May investors and companies cite BRIC as a source of foreign expansion opportunity, due to lower labor costs.

OTC derivatives market in India: Recent regulatory initiatives and measures for market stability

Dayanand Arora, Francis Rathinam 11 May 2010

Over-the-counter derivatives were heavily involved in the spread of the global crisis. This column analyses the regulatory framework for such derivatives in India. It argues that moves to tighten the regulatory rope are unnecessary and that a shift to exchange-traded markets may not bring the desired results. Instead, policymakers should strive towards increased disclosure, more transparency, and more standardisation.

Many believe that over-the-counter (OTC) derivatives exacerbated the global crisis. As a result, a lot of regulatory attention is being focused on how to deal with OTC markets. The financial crisis has also intensified the debate over the limited development of post-trading infrastructure for OTC derivatives. The ECB argues – among others – that the lack of a good post-trading infrastructure not only leads to operational inefficiencies and risks but also hampers effective counter-party risk management and market transparency (ECB 2009).

Adding to this is a new wave of opinion promoting the introduction of a “centralised counter party” to improve transparency by allowing for easy collection of high frequency, market-wide information on market activity, transaction prices, and counterparty exposures for market participants (Cecchetti et al. 2009).

New evidence from India

In a recent ICRIER working paper (Arora and Rathinam 2010) we analyse the regulatory framework of the OTC derivatives market in India and propose new measures for market stability. The OTC derivatives markets in India are well regulated by the central bank. The Reserve Bank of India allows OTC derivatives trading so long as at least one of the parties in the transaction is regulated by the bank. Financial institutions in India use derivatives for their own balance sheet management whereas non-financial firms use derivatives only for hedging their exposures.

The flow chart below depicts the functioning of OTC regulation in India. A centralised counter party, called CCIL, is entrusted with the job of engaging in the OTC derivatives market as a reporting platform and a clearing agency for post-trading settlements. The banks and the primary dealers are required to report all their trades on the reporting platform within 30 minutes of the deal. Since one of the counterparty in an OTC transaction has to be regulated by the Reserve Bank of India regulated entity and has to report to it on a regular basis, the Indian model therefore offers a unique model for automatic surveillance of the
OTC exposure of all banks in India. Additionally, the use of the centralised counter party as a reporting platform on a real-time basis helps the Reserve Bank keep a real-time watch on systemic risk.

Figure 1. Centralised counter party approach – Regulatory framework for Indian OTC derivatives

For all those OTC products, which are guaranteed by CCIL, the guarantee from the centralised counter party reduces the capital requirements for banks up to 80% by eliminating the counterparty risk. At present, CCIL collects initial margin (including spread margin), mark to market margin and other margins like volatility margin (whenever imposed). Such margins are collected in the form of eligible Government-of-India securities or cash or both. A minimum cash margin requirement is generally stipulated to address immediate liquidity needs. CCIL also takes contribution from members to the default fund in specific segments in the form of eligible Government-of-India securities to meet any residual loss.

Since CCIL is the only centralised clearing party for trade processing and settlement services in India, any potential mismanagement in CCIL could have system-wide implications. Concentration can lead to a “moral hazard” problem if the centralised counter party is considered “too big to fail”. The Reserve Bank of India, recognising the systemic nature of a centralised counter party, ensures that CCIL is closely monitored. Further, to eliminate the possibility of CCIL not being able to honour a contract, it maintains a guarantee fund and has adequate lines of credit arrangements with various banks to ensure funds settlement on guaranteed basis for trades in Collaterised Borrowing and Lending Obligations, government securities and forex markets. To ensure good corporate governance, CCIL follows International Organisation of Securities Commission best practices.

We argue that, given the systemic significance of centralised counter parties and the existing concentration of activities in CCIL, the time has come to allow competition in post-trade clearing and settlement of OTC derivatives. Very much like in the market for foreign currency futures, where National Stock Exchange (NSE) and MCX compete as organised exchange-based centralised counter parties, we should start thinking about new infrastructure in OTC derivatives. The entry of one or two more CCPs in the business of post-trade clearing and settlement may bring with it the advantages of operational efficiency and, at the same time, reduce the concentration of risk.

Another measure that could contribute to the strengthening of centralised counter parties relates to increasing liquidity requirements of CCIL. As part of its operations, CCIL sometimes experiences intra-day liquidity shortfalls. To tide over the intra-day liquidity requirements, CCIL has made use of a dedicated line of credit from a few commercial banks. We are endorsing the demand of the Committee for Financial System Assessment (2009) for the grant of a limited purpose banking license, which will enable CCIL to take advantage of a repo window with another bank (or from the Reserve Bank of India) to meet the need for additional liquidity.

The policy implication of our research is that, knowing the functional value of OTC derivatives markets in the Indian financial system, there is no need for new moves to tighten the regulatory rope. Also, a shift of business from OTC-traded to exchange-traded derivative markets may not bring the desired results. Instead, what we propose is a concerted effort towards increased disclosure, more transparency, and more standardisation. In addition to that, towards a better understanding of OTC derivative markets, we suggest that notional outstanding value of contracts is not a correct indicator of the payment risk inherent in this market. It is only the uncollateralised part of the gross credit exposure which the supervisory bodies need to focus on.

Financial services Unit-4
The term “financial services” in a broad sense mean “mobilizing and allocating saving”. Thus, it includes all activities involved in the transformation of saving into investment.

features of financial services.
☐ It is a customer-intensive industry. Identification of need and wants of customer is the first step. It will help the financial service firms to design the financial strategy, which gives due respect to costs, liquidity and maturity consideration.
☐ Demand and supply must be properly balanced.

merchant banking.
The standard definition to the word „merchant bank” is given under:
“Merchant banking means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, underwriting or subscribing to the securities underwriter, manager, consultant, advisor or rendering corporate advisory in relating to such issue management”.

merchant banking?
“An organization that underwrite corporate securities and advise clients on issue like corporate mergers, etc. involved in the ownership of commercial ventures”.

public issue.
By using prospectus, companies raise fund from the public. This is a most common method of raising fund. Companies issue prospectus to issue shares. Shares issues through prospectus are in a fixed number.

right issue?
Existing share holders have pre-emptive right in taking part in the right issue. In right issue, shares are offered to existing share holders according to the proportion of their share holding.

private placement?
The direct sale of shares by a company to investors is called private placement. No prospects are issued in private placement. Private placement covers equity shares, preference shares and debentures.

Project Counselling”.
Project counseling includes preparation of project reports, deciding upon the financing pattern to finance to the cost of the project and apprising project report the financial institutions or banks.

portfolio management.
Portfolio management refers to maintaining proper combination of securities in a manner that they give maximum return with minimum risk.

issue management.
Management of issue involves marketing of corporate securities viz., equity shares, preference shares and debentures or bonds by offering them to public.
advantage of public issue.
  It provides liquidity for the existing share.
  The reputation and visibility of the company increase. It commands better valuation for the company.

forfeiting.
Forfeiting is a technique by which a forfeiter discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills.
Commercial Paper.
A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.

Treasury bill?
A treasury bill is also a money market instruments issued by the central government. It also issued at a discount and redeemed at par. Recently, the government has come out with short term Treasury bill of 182-days bills and 364-days bills.

certificate of deposit?
The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity.

deep discount bond?
There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large discount to their nominal value. This bond could be gifted to any person.

Option bonds.
These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity.

Equity with 100% safety net.
Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at any, irrespective of the market price.

Convertible bonds.
A convertible bond is one which can be converted into equity shares at per-determined timing either fully or partially. They are compulsory convertible bonds which provide fore conversion within 18 months of their issue. There are optionally convertible bonds which provide for conversion within 36 months.

Easy exit bonds.
As the name indicates, this bond enables the small investors to encase the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.

2. Carrot and stick bonds.
Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price.

Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. or both. It represents a certain number of underlying equity shares.

4. Blue chip share.
Share of well known and established companies are called blue chip share. They must show consistent growth over the years. These shares have bright future prospects and they are expected to contribute sustained growth in the future also.
5. **Defensive shares.**
These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors’ money.

6. **Growth shares.**
Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.

7. **Cyclical Vs Non-cyclical shares?**
Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc.
If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.

8. **Turn around Shares?**
Turn around shares is those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.

9. **Active Shares?**
Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold at least three times a week. Investors can buy or sell these shares quite easily in the market.

10. **Alpha Shares?**
Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

11. **Sweat shares?**
Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

12. **Financial Engineering?**
Thus, the growing need for innovation has assumed immense importance in recent times. This process is being referred to as financial engineering. Financial engineering is the lifeblood of any financial ability “Financial engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance”

13. **Loan Syndication?**
This is more or less similar to „consortium financing”. It refers to a loan arranged by a bank called leader manager for a borrower who is usually a large corporate customer or a Government Department. The other banks who are willing to lend can participate in loan by contributing an amount suitable to their own lending polices. Since a single bank cannot provide such a huge sum as loan, a number of banks joint together and form a syndicate.
14. **Leasing?**
A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called “rental charges”. The lessee can not acquire any ownership to the asset, but he can use it and have full control over it. He is expected to pay for all maintenance charges and repairing and operating costs.

15. **Venture Capital?**
A venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project. It is in contrast to the conventional “security based financing”. Much thrust is given to new ideas or technological innovations. Finance is being provided not only for „start-up capital” by the financial intermediary.

16. **Securitization?**
Securitization is a technique where by a financial company converts its illiquid, non-negotiable and high value financial assets into securities of small value which are made tradable and transferable. A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc.

17. **Reverse Mortgage?**
In a Reverse Mortgage the owner of a house property surrenders the title of his property to a lender and raises money, a lender does not pay the entire amount. On the other hand, he pays out a regular sum each month for the agreed time. The owner, normally a senior citizen, can use the property and stay with his spouse for the rest of their lives. Thus, the owner can ensure a regular cash flow in times of need and enjoy the benefit of using the property. Usually, after the death of the owner, the spouse can continue to use the property. In case, both die during the period of the RM scheme the lender will sell the property, take his share and distribute the rest among the heirs. It is called reverse mortgage because the payment steam is “reversed”.

18. **Derivative Security.**
A derivative security is a security whose value depends upon the value of other basic variables backing the security. In most cases, these variables are nothing but the prices of traded securities. A derivative security is basically used as a risk management tool and it is to cover the risks due to price fluctuations by the investments manager. Naturally the value of a derivative security depends upon the value of the backing security.

19. **Forward contracts.**
A forward transaction is one where the delivery of a foreign currency currently takes place at a specified future date for a specified price. It may have a fixed maturity for, e.g. 31st May or a flexible maturity for e.g. 1st to 31st May. Forward contracts are permitted only for genuine business transactions.

20. **Swaps?**
A swap refers to a transaction where in a financial intermediary buys and sells a specified foreign currency simultaneously for different maturity dates-say, for instance, purchase of spot and sale of forward or vice versa with different maturities. Thus, swaps would result in simultaneous buying and selling of the same foreign currency of the same value for different maturities to eliminate exposure risk.

21. **Letter of credit (LOC).**
It is an innovative funding mechanism for the import of goods and service on deferred payment terms. LOC is institution/bank of one country with another institution/bank/agent to support the export of goods
and services so as to enable the importers to import no differed payment terms. This may be backed by a
guarantee furnished by the institution/bank in the importing country. The greatest advantage is that it saves
a lot of time and money on natural”s verifications of bonafides, source of finance etc. It serves as a source
of forex.

1. characteristics of financial services.
   - It is a customer-intensive industry. Identification of need and wants of customer is the first step. It
     will help the financial service firms to design the financial strategy, which gives due respect to costs,
     liquidity and maturity consideration.
   - Financial services are intangible in nature. The institution providing the services should have a
     good image and confidence of the client. The have to focus on quality and innovativeness of their services,
     this will build credibility and gain the trust of clients.
   - Production and supply of financial services must be performed simultaneously. This demands a
     clear-cut organization and their clients.
   - Demand and supply must be properly balanced. This is because of the perishable nature of
     financial services.
   - Marking of financial people intensive. It is subject to variability of performance and quality of
     service. The personnel in financial services firms need to be selected, based on their suitability.
   - Financial services firm should always be proactive in visualizing in advance what the market
     wants, or reactive to the needs and wants of customers. They must always be changing to the tune of the
     market.

2. classifications of financial services industry?
The financial intermediaries in India can be traditionally classified into two:
   - Capital market intermediaries and
   - Money market intermediaries.
The capital market intermediaries consist of term lending institutions and investing institutions which
mainly provide long term funds. On the other hand, money market consists of commercial banks, co-
operative banks and other agencies which supply only short term funds. Hence, the term „financial
services industry” includes all kinds of organizations which intermediate and facilitate financial
transactions of both individuals and corporate customers.

3. scope of merchant banking in India.
   - Growth of new issue market
     The growth of new issue market is unprecedented since 1990-91. The amount of annual average of capital
     issue by non-government public companies was only about 90crs in 70s, the same rose to over Rs.1000crs
     in the 80"s and further to Rs.12700crs in the first 4 years of 1990"s. The figure could be well beyond
     Rs.40000crs by the end of 1994-95.
   - Entry of foreign investors
     An outstanding development in the history of Indian capital market was its opening up in 1992 by allowing
     foreign institution investors to invest in primary and secondary market and also permitting Indian
     companies to directly tap foreign capital through euro issue. Within two years to march 1994, the total
     inflow of foreign capital through these routes reached to about 5bills.
   - Changing policy of financial institutions
With the changing emphasis in the lending policies of financial institutions from security ordination to project orientation, corporate enterprises would require the expert services of merchant bankers for project appraisal, financial management.

Development of debt market
The concept of debt market has set to work through national stock exchange and the over the counter exchange of India. Experts feel that of the estimated capital issue of Rs.40000crs in 1994-95 a good portion may be raised through debt instruments. The development of debt market will offer tremendous opportunity to merchant bankers.

Innovations in the instruments
The Indian capital market has witnessed innovations in the introduction of financial instrument such as non-capital debentures with detachable warrants, cumulative convertible preference shares, zero coupon premium notes, floating rate bonds, auction rate debentures etc.

Corporate restructuring
As a result of liberalization and globalization the competition in the corporate sector is becoming intense. To survive in the competition; companies are reviewing their strategies, structure and function.

4. The guidelines for merchant bankers issued by Securities and Exchange Board of India (SEBI).
   Merchant banking has been statutorily brought within the framework of the securities and exchange board of India under SEBI [merchant bankers] regulation, 1992.
   1. The criteria for authorization include:
      Professional qualification in financier, law or business management. Infrastructure like adequate office space, equipment and manpower.
      Employment of two persons who have the experience to conduct business of merchant bankers.
      Capital adequacy.
      Past track of record, experience, general reputation and fairness in all transactions.
   2. Securities and Exchange Board of India (SEBI) issued further guidelines classifying the merchant banker into four categories based on the nature and range of activities and their responsibilities to SEBI investors and issuers of securities.
      The second category consists of those authorized to act in the capacity of co-manager/advisor, consultant, and underwriter to an issue or portfolio manager.
      The third category consists of those authorized to act as underwriter, advisor or consultant to an issue.
      The fourth category consists of merchant bankers who act as advisor.
      The above classification was valid up to December 1997 only.
   3. An initial authorization fee, an annual fee and renewal fee may be collected by Securities and Exchange Board of India (SEBI)
   4. All issues must be managed at least by one authorized banker, function as the sole manager or the lead manager. Ordinarily not more than two merchant bankers should be association as lead managers.
   5. Each merchant banker is required to furnish to the Securities and Exchange Board of India (SEBI) half yearly unaudited financial result when required by it with a view to monitor the capital adequacy of the merchant banker.
   6. The lead merchant banker holing a certificate under category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakhs whichever is less.
   7. The above guidelines will be administered by Securities and Exchange Board of India (SEBI) and it will supervise the activities of merchant bankers.
   8. Securities and Exchange Board of India (SEBI) has been vested with power to suspend or cancel the authorization in case of violation of the guidelines.
   The notification procedure relating to action to be initiated against merchant banks in case of default has been detailed out. The regulations empower Securities and Exchange Board of India (SEBI) to take action against defaulting banker such as suspension/cancellation of registration.
5. the detail the merchant banking in India.
In India prior to the enactment of Indian companies act, 1956, managing agents acted as issue hours for securities, evaluated project reports, planned capital structure and to some extent provided venture capital for new firms. Few share broking firms also functioned as merchant bankers.
The need for specialized merchant banking service was felt in India with the rapid growth in the number and size of the issues made in the primary market. The merchant services were started by foreign banks, namely the national grind lays bank in 1967 and city bank in 1970. The banking commission in its report in 1972 recommended the setting up of merchant banking institutions, this market the beginning of specialized merchant banking in India.
The begin with, merchant banking services were offered along with other traditional banking services in the mid-eighties, the Banking Regulations Act was amended
permitting commercial banks to offer a wide range of financial services through the subsidiary rule. The state bank of India was the first Indian banks to set-up merchant its merchant banking division in 1972. Later bank ICICI set up its merchant banking division followed by bank of India, bank of Baroda, Punjab national bank and UCO Bank. The merchant banking gained prominence during 1983-84 due to new issue boom.

6. the issue management.
Issue management refers to management of securities offering of client to the general public and existing shareholders on right basis. Issue managers are known as merchant banker or lead managers. Merchant banker has many more tasks to be carried out. Of which, issue management is the most important and sizable function within. The terms „merchant banking” and „issue management” are generally used interchangeably.
Public issue and right issue of more than Rs.50lakhs is required to be managed by a category merchant banker under Securities and Exchange Board of India (SEBI) guidelines. Industry of present is badly in need of funds. Issue management has tremendous scope and potential in supplying such funds to the industry,
Merchant bankers provide their skills and experience to clients in managing the capital issues. It essentially aims at converting the saving of household into viable investment of clients. The investment covers investment on new projects, expansion, modernization and diversification of existing units and augmenting the long-term sources for working capital purpose. Issues are of three types, a) public issue b) Right issue, C) Private Placement.

7. the functions of a Merchant Banker.
The following comprise the main functions of Merchant Banker: Management of debt and equity offerings
This forms the main function of the Merchant Banker. He assists the companies the raising from the market. The main areas of work in this regard include: instrument designing, pricing the issue, registration of the offer document, underwriting support, and marketing of the issue, allotment and refund, listing on stock exchanges.

Promotional activities
A merchant bank functions as a promoter of industrial enterprises in India. He helps the entrepreneur in conceiving an idea, identification of projects, preparing feasibility reports, obtaining Government approvals, and incentives etc.
Placement and distributions
The merchant banker helps in distributing various securities like equity shares, debt instruments, mutual fund products, fixed deposits, insurance products, commercial papers to name a few. The distribution network of the merchant banker can be classified as instructional and retail in nature.

Project advisory services
Merchant bankers help their clients in various stages of the project undertaken by the clients. They assist them in conceptualizing the project idea in the initial stage. Once the idea is formed, they conduct feasibility studies to examine the viability of the proposed project.

Loan syndication
Merchant bankers arrange to tie up loans for their clients. This takes place in a series of steps. First, they analyze the pattern of the client’s cash flows, based on which the terms of borrowing can be defined. Then the merchant banker prepares a detailed loan memorandum, which is circulated to various banks and financial institutions and they are invited to participate in the syndicate. The banks then negotiate the terms of lending based on which the final allocation is done.

Providing venture capital and mezzanine financing
Merchant bankers help companies in obtaining venture capital financing for financing their new and innovative strategies.

Leasing Finance
Merchant Bankers provide leasing finance facilities to their clients.

Bought out deals
It involves a deal where the entire securities are bought in lots. It is done with an intention of offloading them later in the market. The deal is done in two stages—first, the client issues shares to the retail investors at a higher price. The merchant banker is required to appraise the project, invest in the client and offer the shares to the public for subscription. The client, on the other hand, need not wait for months together to use the issue proceeds and gets an attractive price for his shares. In addition, it allows companies to raise capital without facing the uncertainties of the market place.

Non-resident Investment
The merchant bankers provide investment advisory services in terms of identification of investment opportunities, selection of securities, portfolio management, etc. to attract NRI investment in the primary and secondary markets.

Advisory services relating to mergers and acquisitions
Mergers and takeovers are popular in these days. There may be several reasons for mergers and acquisitions. They vary from elimination of competition, expansion of capital through tie-ups and to go global.

Portfolio management
Merchant bankers offer services not only to the clients issuing the securities but also to the investors. They advise their clients, mostly institutional investors, regarding investment decisions. Merchant bankers even undertake the function of purchase and sale of securities for their clients to provide them:

(a) To identify the potential targets of takeovers,
(b) To appraise the merger/takeover proposals with respect to financial viability and technical feasibility,
(c) To negotiate with interested parties,
(d) To determine the purchase consideration and the appropriate exchange offer,
(e) To assist in matters related to procedural and legal aspects, and
(f) To obtaining necessary approvals.

Financial services cover a wide range of activities. They can be broadly classified into two namely:
(i) Traditional activities

(ii) Modern activities

Traditional activities
Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads viz;

Fund based activities and
Non-fund based activities

The traditional services which come under fund based activities are the following:

(i) Underwriting of or investment in shares, debentures, bonds etc, of new issues (primary market activities)
(ii) Dealing in secondary market activities.
(iii) Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc.
(iv) Involving in equipment leasing, hire purchase, venture capital, Seed capital etc.
(v) Dealing in foreign exchange market activities.

Non-fund based activities
Financial intermediaries provide services on the basis of non-fund activities also. This can also be called “fee based” activity. They expect more from financial service companies. Hence, a wide variety of service, are being provided under this head they including the following:

(i) Making arrangements for the placements of capital and debt instruments with investments institutions.
(ii) Arrangements of fund from financial institutions for the clients” project cost or his working capital requirements.
(iii) Assisting in the process of getting all government and other clearances.

Modern activities
Besides the above traditional services, the financial intermediaries render innumerable service in recent times. Most of them are in the nature of non-fund based activity. In view of the importance, these activities have been discussed in brief under the head „New financial products and services”. However, some of the modern services provided by them are given in brief hereunder:

(i) Rendering project advisory services right from the preparation of the project report till the raising of funds for starting the project with necessary government approval.
(ii) Planning for mergers and acquisitions and assisting for their smooth carry out.
(iii) Guiding corporate customers in capital restructuring.
(iv) Acting as trustees to the debenture-holders.
(v) Recommending suitable changes in the management structure and management style with a view to achieving better result.

9. Write any ten innovative financial instruments.

Commercial paper
A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.

Treasury bill
A treasury bill is also a money market instruments issued by the central government. It also issued at a discount and redeemed at par. Recently, the government has come out with short term Treasury bill of 182-days bills and 364-days bills.
Certificate of deposit
The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity.

Deep discount bonds
There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large discount to their nominal value. This bond could be gifted to any person.

Option Bond

These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity.

Equity with 100% safety net
Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at any, irrespective of the market price.

Convertible bonds
A convertible bond is one which can be converted into equity shares at per-determined timing either fully or partially. They are compulsory convertible bonds which provide for conversion within 18 months of their issue. There are optionally convertible bonds which provide for conversion within 36 months.

Easy exit bond
As the name indicates, this bond enables the small investors to encash the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.

Carrot and stick bonds
Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price.

Global depository Receipt (GDR)
Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. or both. It represents a certain number of underlying equity shares.

10. the Classification of equity shares
Blue chip share
Share of well known and established companies are called blue chip share. They must show consistent growth over the years. These shares have bright future prospects and they are expected to contribute sustained growth in the future also.

Defensive shares
These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors’ money.

Growth shares
Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.

Cyclical Vs Non-cyclical shares
Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc.
If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.

- **Turn around Shares**
  Turn around shares are those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.

- **Active Shares**
  Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold at least three times a week. Investors can buy or sell these shares quite easily in the market.

- **Alpha Shares**
  Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

- **Sweat shares**
  Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

11. Write about challenges facing the financial services sector.

However, the financial service sector has to face many challenges in its attempt to fulfill the ever growing financial demands of the economy. Some of the important challenges are briefly reported hereunder:

- **Lack of qualified personnel**
  The financial services sector is fully geared to the task of financial creativity. However, this sector has to face many challenges. In fact, the dearth of qualified and trained personnel is an important impediment in its growth.

- **Lack of investor awareness**
  The introduction of new financial products and instruments will be of no use unless the investor is aware of the advantages and uses of the new and innovative products and instruments.

- **Lack of transparency**
  The whole financial system is undergoing a phenomenal change in accordance with the requirements of the national and global environments. It is high time that this sector gave up their orthodox attitude of keeping accounts in a highly secret manner. Hence, this sector should opt for better levels of transparency.

- **Lack of specialization**
  In the scene, each financial intermediary seems to deal in different financial service lines without specializing in one two areas. In other words, each intermediary is acting as financial super market delivering so many financial products and dealing in different varieties of instrument.

- **Lack of recent data**
  Most of the intermediaries do not spend more on research. It is very vital that one should build up proper data base on the basis of which one could embark upon financial creativity. Moreover a proper data base would keep oneself abreast of the recent developments in other parts of the whole world and above all, it would enable the fund managers to take sound financial decisions.

12. Critically analyses the present position of the financial service sector in India.

- **Conservation to dynamism**
  At present, the financial system in India is in a process of rapid transformation, particularly after the introduction of reforms in the financial sector. The main objective of the financial sector reforms is to promote an efficient, competitive and diversified financial system in the country. This is essential to rise
the allocate efficiency of available savings, increase the return on investment and thus to promote the accelerated growth of the economy as whole.

Emergence of Primary Equity Market
Now, we are also witnessing the emergence of many private sector financial services. The capital markets which were very sluggish have become a popular source of raising finance. The number of stock exchanges in the country has gone up from 9 in 1980 to 22 in 1994. The aggregate funds raised by the industries in the primary markets have gone from Rs. 5976 crore in 1991-92 to Rs. 32382 crore in 2006-07.

Concept of Credit Rating
There is every possibility of introducing Equity Grading. Hitherto, the investment decisions of the investors have been based on factors like name recognition of the company, operations of the Group, market sentiments, reputation of the promoters etc. Now, grading from an independent agency would help the investor in his portfolio management and thus, equity grading is going to play a significant role in investment decision-making.

Process of Globalisation
Again, the process of globalization has paved the way for the entry of innovative and sophisticated financial products into our country. Since the government is very keen in removing all obstacles that stand in the way of inflow of foreign capital, the potentiabilities for the introduction of innovative international financial products in India are very great.

Process of Liberalization
Realizing all these factors, the government of India has initiated many steps to reform the financial services industry. The government has already switched over to free pricing issues by the controller of capital issues. The interest rates have been deregulated. The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized.

1. Mutual Funds.

According to Weston J. fed and Brigham, Euqene, F., units trust are “corporations which accept dollars from savers and then use these dollars to buy stock, long term bonds, short term debt instruments issued by business or government units; these corporations pool funds and thus reduce risk y diversification.”

2. Mutual fund?

A mutual fund is a trust that pools the saving of number of investors who share a common financial goal. Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors.

3. different types of Mutual Funds.

Operational classification
Open ended mutual fund Close ended mutual fund Interval funds

Portfolio classification
Growth oriented funds   Income oriented funds   Balanced funds
Bond funds
Stock funds Index funds
Geographical funds classifications

Structural classification

4.   the regulation of SEBI on the Mutual funds.

The mutual fund company must be a registered company

Capital structure must be according to the regulations stipulated by SEBI

Every mutual fund company must give their Net Asset value periodically preferably weekly in the leading newspapers of the country.

5.   Net Asset Value?

The Net Asset value of the fund is the cumulative market value of the assets of the fund net of its liabilities. In other words, the fund is dissolved or liquidated by selling off all the asset in the fund, this is the amount that the shareholders would collectively own.

6.   Balanced fund?

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

7.   Gilt fund?

These funds invest exclusively in government securities have no default risk NAVS of these schemes also fluctuate due to change in interest rates and others economic factors as is the case with income of debt oriented schemes.

8.   term Money Market Mutual fund?

These funds are generally invested in money market instruments such as treasury bills certificate of deposit. Commercial paper, bills discounting, etc. these are regulated on the basis of specified guidelines laid down by the reserve Bank of India.

9.   specialized fund?
A large number of specialized funds are existence abroad. They offer special schemes so as to meet the specific needs of specific categories of people like pensioners. Widows etc. There are funds for investments in securities of specified areas.

10. UTI?

UTI was set up in 1964 by an act of parliament. It commenced its operation from July 1964 with a view to encouraging saving and investment and participation in the income, profit and gain accruing to corporation from the acquisition, holding management and disposal of securities.

11. Index funds?

Index funds invest only in those shares which are included in the market indices and in exactly the same proportion. Whenever the market index goes up the value of such index funds also goes up. Conversely when the market index comes down the value of such index funds also goes down.

12. features of Closed – ended funds.

The period and/or the target amount of the fund are definite and fixed beforehand. Once the period is over and/or the target is reached, the door is closed for the investors they cannot purchase any more units.

13. features of Open – ended funds.

These units are not publicity traded but, the fund is ready to repurchase them and resell them at any time. The main objectives of this fund is income generation the investors get dividend relight or bonuses as rewards for their investment

1. the types of Mutual funds?

Mutual funds can be classified under four different categories

1. Operational classification
2. Portfolio classification
3. Geographical classification
4. Structural classification

Operational classification

Mutual funds are broadly categorized into three types, namely
a) open ended mutual funds,

b) close ended mutual funds,

c) Interval funds

Open ended Mutual funds:

SEBI regulations defines open ended schemes “a scheme of a mutual funds which is offering units for sales or has outstanding any redeemable units and which does not specify any duration for redemption or repurchase or units” open ended mutual funds all open throughout the year for investment and redemption the units are bought and sold directly by the fund.

Closed ended Mutual funds:

Closed end mutual funds have a definite period after which their shares / units are redeemed. The units are offered to the investors through the public issue and after the date of closure, the entry to the investor is closed. Closed end mutual fund schemes are generally trades among the investors in the secondary. Market since they are to be quoted stock exchange.

Interval funds:

Interval funds combine the features of open ended and closed ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

Portfolio classification:

Mutual funds differ with reference to their instruments therefore, different mutual funds are designed to meet the needs of the investors this section discusses the types of mutual funds classified on the basis of their portfolio

Income oriented funds:

The main objectives of this fund is to provide regular income to the investors in the form of dividends the dividends may be cumulative or non-cumulative on a quarterly, half yearly, or yearly basis.

Balanced funds:

These funds aim at distributing both income and capital appreciation to the investors. Technically the corpus of this scheme is invested quality in high growth equity shares and fixed income earning debentures.

Geographical classification:

On the basis of geographical limits, mutual funds schemes can be classified as domestic mutual funds and off share mutual funds.

Domestic mutual funds:

Domestic mutual fund schemes mobilize the savings of the citizens of the county. However the NRIs and foreign investors can invest in these schemes. All the schemes in vogue in the country are the domestic mutual fund schemes.

Off share Mutual funds:
These funds enable the NRIs and international investors to participate in Indian capital market further these funds are governed by the rules and procedures laid down for the purpose of approving and monitoring their performance by the department of economic affairs, ministry of finance and the direction of RBI.

Structural classification:

Structure, mutual funds can be divided in two categories namely a capital market mutual funds and money market mutual fund. Mutual funds generally invest the pooled resources in capital market instruments whereas money market mutual funds invest in money market instrument

2. the advantages of Mutual fund?

Advantages of mutual funds

Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors. The dividend fluctuates with the income on mutual funds” investments mutual funds are advantages to individual investors in relation to their direct involvement in investment portfolio activity covering the following aspects.

1. Reduced Risk:

Mutual funds provide investors access to reduced investment risk resulting from diversification, economics of scale in transaction cost and professional finance management.

2. Diversified investment

Small investors participate in larger basket of securities and share the benefits of efficiently managed portfolio by expects and are freed of keeping any records of share certificates etc.

3. Stress free investment

Investors get freedom from emotional stress involved in buying or selling securities mutual funds relieve them from such stress as it is managed by professional experts who act scientifically with right timing in buying and selling for their clients.

4. Revolving type of investment

Automatic reinvestment of dividends and capital gains provides relief to investors so that invested funds generates higher return to them the members of mutual funds.

5. Wide investment opportunities

A ailment of wider investment opportunities that create an increased level of liquidity for the funds holders become possible because of package of more liquid securities in the portfolio of mutual funds.

6. Selection and timings of investment

Expertise in stock selection and timing is made available to investors so that invested fund generates higher returns to them.

3. Review the growth of Mutual funds in India?
The fundamentals are strong and macro-economic indicators are strong one would expect most sectors to perform well and are expecting a bull run in the market is expected to gain around 20-25% and mutual funds will be able to provide those kind of returns enabling one to take advantage of the markets.

The economy slowly picked up after September's issues. In year 2002 however poor monsoon affected the stock markets. Disinvestments stores, securitization bill, security interest bill, entrance of IT element and other positive news boosted the stock market and that helped the equity funds to post the good returns. Fixed income markets witnessed a steep decline in interest rate of around 300 basis points in 2001.

4. the various schemes of UTI for different categories of investors?

Specific investment schemes of UTI as a mutual fund that are beneficial to mutual fund holders are given below.

1. Income Plan
2. Growth Plan
3. Reinvestment Plan
4. Systematic Plan
5. Systematic withdrawal plan
6. Insurance plan

Income plan

The mutual funds distribute a substantial part of the surplus to investors in the dividends.

Growth plan

An investors realize only capital appreciation on the investment and normally does not get any income in the form of income distribution.

Investment plan

Here, the accrued income is reinvested in the purchase of additional units.

Systematic investment plan

The investor is given the option of managing investment on a periodical basis and thus inculcating a regular saving habit. He may issue pre-determined number of postdated cheques in favour of the fund.

Systematic withdrawal plan

This is quite opposite to the systematic investment plan. In systematic withdrawal plan, investor is given the open of withdrawing his investment among at a pre-determined date and among from the fund.

Insurance plan

Here, the investors are given an insurance cover against life or personal accident example L unit linked insurance plan UTI.

5. To want expend commercial Banks in India are better fitted to take up the Mutual funds Commercial banks and mutual funds:

With a view to providing wider choice to small investors, the government of India has permitted the banks to enter into the field of mutual funds due to the following reason.
Banks are not able to provide better field to the investing public with their saving and fixed deposit interest rates whereas many financial intermediates with innovative market instrument offering very attractive returns, have earner the financial market.

The gross domestic savings has risen from 10% in fifties to 20% in righties, thanks to the massive branch expansion programmed of banks and their growing deposit mobilization.

Indian investors, particularly small and medium ones, are not very keen in investing any substantial amount directly in capital market instrument. They may also hesitate to invest in an indirect way through private financial intermediaries.

Earlier banks were not permitted to tap the capital market for funds or to invest their funds in the market. Now a green signal has been given to them to enter into this market and reap the maximum benefits.

Banks can provide a wider range of products services in mutual fund by introducing innovative schemes and extend their professionalism to the mutual fund industry.

Banks, as merchant banks have wide experience in the capital market and hence managing mutual fund may not be a big problem for them.

The entry of banks would provide much needed competition in the mutual fund industry which has been with to monopolize by the UTI. The competition will improve customer service and wider customer choice also.

6. the features of open ended funds?

There is complete flexibility with regard to one”s investment or disinvestment. In other words, there is free entry and exist of investors in an open ended fund.

These units are not publicly traded but the fund is ready to repurchase them and resell them at any time.

The investor is offered instant liquidity in the sense that the units can be sold on any working day. In fact, the fund operates just like a bank account where in 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 onuses as rewards for their investment.

Since the units are not listed on the stock market, their prices are linked to the net asset value of units. The NAV is determined by the fund and it varies from to time.

Generally, the listed prices are very close to their Net Asset value. The fund fixes a different price for their purchases and sales.

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 the scheme.

1. leasing

Dictionary of business management „,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 a rent.

2. leverage lease and non- leveraged leases?
The value of the assets leased may be of a huge amount which may not be possible for the lessor to financial so the lessor involves one more financial who will have charge over the leased asset.

3. financial lease

Financial lease is a contract involving payment over a longer period. It is long term lease and the lessee will be paying much more than the cost of property or equipment to the lessor in the form of lease charges it is irrecoverable. In this type of leasing the lessee has to bear all costs and the lessor does not render any services.

4. operating lease?

The lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice. In this type of leasing (a) lessor bears all expenses (b) lessor will not be able to the realise the full cost of the asset (c) specialized services are provided by the lessor.

5. cross border lease?

Lease across national frontiers are called cross border lease shipping, air service etc., will come under this category.

6. the advantages of leasing?
   1. Permit alternative use of funds
   2. Faster and cheaper credit
   3. Flexibility
   4. Facilitates additional borrowings
   5. Protection against obsolescence
   6. No restrictive covenants
   7. Hundred Percent tenanting
   8. Boom to small firm.

7. disadvantages of leasing?
   1. Certain tax benefits incentives such as subsidy may not be available on leased equipment.
   2. The cost of financing is generally higher than that of debt financing.

8. the different types of leasing
   1. Financial lease.
2. Operating lease.
3. Leveraged and non leveraged lease
4. Conveyance type lease
5. Sale and lease pack
6. Full and non pay – out lease.
7. Specialized service lease.
9. Sales aid lease.
10. Cross border lease.
11. Tax oriented lease.
12. Import leasing.
13. International lease.

9. flexibility?

Leasing arrangement may be tailored to the lessee”s needs more easily that 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 below.

10. contents of lease agreement
1. Description of the lessor, the lessee, and the equipment.
2. Amount, time, and place of lease rental payments.
3. Time and place of equipment delivery.

11. the problems of leasing
1. Unhealthy competition
2. Lack of qualified personnel
3. Tax considerations
4. Stamp duty
5. Delayed payment and bad debts.
12. lease finance?

Here a third party comes into the contract by financing the lessor for purchasing the asset or equipment which is meant for leasing. The financial may have a control over machinery by a separate contract with lessor.

1. different types of leasing?

Definition of leasing

“Lease is a contract where by the owner of an asset grants to another party the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent”.

Types of leasing

1. Financial leasing.
2. Operating leasing.
3. Leveraged and non – leveraged leases.
4. Conveyance type lease
5. Sale and lease pack
6. Full and non pay – out lease.
7. Specialized service lease.
9. Sales aid lease.
10. Cross border lease.
11. Tax oriented lease.
12. Import leasing.
13. International lease.

Financial lease:

It is a contract involving payment over a longer period it is a long – term. lease and the lessee will be payment much more than the cost of the property or equipment to the lessor in the form of lease charges.
Operating lease:

The lessee used the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks.

1. Lessor bears all expenses
2. Lessor will not be able to realize the full cost of the asset.
3. Specialized service is provided by the lessor.

Leveraged and non–leveraged leases

The value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So the involves one more financier who will have charge over the leased asset.

Conveyance type lease:

Here the lease will be for a long- period with a clear intention of conveying the ownership of title on the lessee.

Sale and lease pack:

Here a company owning the asset sells it to the lessor. The lessor pays immediately for the assets but leases the asset to the seller. This arrangement is done so that the selling company obtains finance for running the business along with the asset.

Full and non pay-out lease:

A full pay-out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay–out lease. The lessor leases out the same asset over and over again.

Specialized service lease:

The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods automobiles, air conditioners, etc.

Net and non-net lease:

In non-net lease, the lease in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

Sales aid lease:

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

Cross border lease:

Lease across national frontiers are called cross border lease. Shipping, air service, etc. will come under this category.

Tax oriented lease:

Where the lease is not a loan on security but qualities as a lease, it will come under this category.

Import leasing:
Here the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

International lease:

Here the parties to the lease transactions may belong to different countries which are almost similar to cross border lease.

2. the advantages of leasing?

☐ Most of the leasing agreements are modified according to the requirement of the lessee.
☐ The lessee is able to derive the benefits out of the asset without owning it.
☐ The lessee is able to save considerable amount of capital which otherwise will be locked up the asset.
☐ Leasing is the cheapest and fastest mode of acquiring an asset, from the creditor's point of view; it is the safest method of finance as they have a good security in the form of asset.
☐ Capital projects can be financed by leasing method and hence most of the financial institutions have started entering leasing business.
☐ Because of leasing, the lessee is able to have better debt-equity ratio. He can also go for additional borrowings in case of business requirement.
☐ It is only by leasing method, 100 percent finance is available for buying equipment
☐ Equipment which is likely to be obsolete very soon can be acquired under operating leasing.
☐ Small scale industries will be benefited by leasing as they can go for modernization of production.
☐ Technocrats will get more benefits by leasing as the promoters will find it difficult to contribute margin money.
☐ The lease charge forms a part of profit & loss a/c and does not appear in the balance sheet. Hence, the return on investment for the investment capital.
☐ Tax benefits are available to both lessor and lessee in leasing.
☐ Leasing is the best method available to monopoly companies to escape MRTP commission.

3. Different between financial lease and operating lease.

Financial lease

Operating lease

1. The asset is procured purely for the benefit of the lessee and the lessor has lesser benefit compared to the lessee.

2. The risk and benefit of the asset is passed on to the lessee and only owner ship is with the lessor.
3. It the asset becomes obsolete, it is the risk of the lessee.

4. The lessor is more concerned with the rent or lease amount as there is repayment of the principal amount along with the interest.

5. The lease is non revocable or irrevocable by either party.

6. Lease period goes along side with life of the asset and there is primary and secondary period.

7. The lessor is only financier and does not
   1. The asset is meant for a number of lessees.

2. The lessee is in possession of the asset only for a particular time and hence risk is more borne by lessor.

3. Since the lease time is short. The risk of obsolescence is with the lessor.

4. The lessor is not only concerned with the rentals. But also the asset as it has to be given to number of lessees.

5. The lease is revocable especially by the lessee.

6. The lease period is small and the lessor leases the asset number of time with different users.

bear the cost of operation.

8. It is mostly a single lease by which the lease repays the cost of the asset with interest
7. The lessor bears cost of repair, maintenance etc.

8. The lease is non pay-out and lessor can recover the value of asset only by repeated leasing to different lessees.
4. disadvantages of leasing?

- Lease is not suitable mode of project finance. This is because rental are repayable soon after entering into lease agreement which in new projects cash generations may start only after a long gestation period.
- Certain tax benefits/ incentives such as subsidy may not be available on leased equipment.
- The value of real assets such as land and building may increase during lease period. In such a case the lessee loses the advantages of a potential capital gain.
- The cost of financing is generally higher than of debt financing.
- A manufacturer who wants to discontinue a particular line of business will 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 his will.
- If the lessee is not able to pay rentals regularly, the lessor would suffer a loss particularly when the asset is a sophisticated one and less liquid.
- In case of lease agreement, it is lessor who has purchased the asset from the supplier and not 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 leased assets.
- In the absence of exclusive laws dealing with the lease transaction several problems crop up between lessor and lessee resulting in unnecessary complications and avoidable tension.

5. structure of leasing industry in India

The present structure of leasing industry in India consists of (i) private sector leasing and (ii) Public sector leasing.

The private sector leasing consists of:

- Pure leasing companies.
- Hire purchase and finance companies, and
- Subsidiaries of manufacturing group companies.

The public sector leasing organizations are divided into

- Leasing divisions of financial institutions.
- Subsidiaries of public sector banks. And
- Other public sector leasing organizations.

Pure leasing companies

These companies operate independently without any like 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, full under this category.

Hire purchase and finance companies:

The companies started prior to 1980 to do hire purchase and finance business especially for vehicles added to their activities during 1980 some of them do leasing as major activity and some other do leasing on a
small scale as a tax planning device sundaram finance limited and motor and general finance limited belong the company.

Subsidiaries of manufacturing group companies

There 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 such 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 requirement or to avoid the income tax liabilities of the group companies.

Public sector leasing:

(i) Financial institutions

The financial institutions such as IFCI, ICICI, IRBI and NSIC have setup their leasing business. The shipping credit and investment company of India offers leasing facilities in foreign currencies for ships, deep, seas fishing vehicles and related equipment to its clients.

Subsidiaries of banks:

The commercial banks in India can, under section 19(1) of the banking Regulation Act 1949, setup subsidiaries for undertaking leasing activities. The SBI was the first bank to start a subsidiary for leasing business in 1986.

Other public sector organizations.

A few public sector manuifacturing companies such as bharat electronics limited. Hinadustan packaging company limited. Electronic corporation their equipment through leasing.

6. What are the problems of leasing in India?

Leasing has great potential in India. However, leasing in India faces serious handicaps which may mar its growth in future. The following are some of the problems.

i) Unhealthy competition:

The market for leasing has not grown with the same pace as the number of lessors. As a result, there is over supply of lessors leading to competition, with the leasing business becoming more competitive, the margin. Profit for lessors has dropped from four to five percent to the present 2.5 to 3 percent. Bank subsidiaries and financial institutions have the competitive edge over the private sector concerns because of cheap source of finance.

ii) Lack of qualified personnel:
Leasing requires qualified and experienced people at the helm of its affairs. Leasing is a specialized business and persons constituting its top management should have expertise in accounting, finance, legal and decision areas. In India, the concept of leasing business is of recent one and hence it is difficult to get right man to deal leasing business on account of this, operations of leasing business are bound to suffer.

iii) Tax consideration:

Most people believe that lessees prefer leasing because of the tax benefits it offers. In reality, it only transfers, the benefit, i.e., the lessee’s tax shelter is lessor’s burden. The lease becomes economically viable only when the transfer’s effective tax rate is low. In addition, taxes like sales tax, wealth tax, additional tax, surcharge, etc. add to the cost of leasing. Thus leasing becomes more expensive from the financing than conventional mode of finance such as hire purchase.

iv) Stamp duty:

The states treat a leasing transaction as sales for the purpose of making them eligible to sales tax. On the contrary, for stamp duty the transaction is treated as a pure transaction. Accordingly a heavy stamp duty is levied on lease document. This adds to the burden of leasing industry.

v) Delayed payment and bad debts:

The problem of delayed payment of rents and bad debts add to the costs of lease. The lessor does not take into consideration this aspect while fixing the rentals at the time of lease agreement. These problems would disturb prospects of leasing business.

1. “Hire purchase”?

Hire purchase is a method of selling goods. In a hire purchase transaction the goods are let out on hire by a finance company (creditor) to 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 creditors and passes on to hirer on the payment of last installment.

2. Hire Purchaser?

Hire purchaser of hirer means the person who purchase an asset under hire purchase system

3. Hirer?

Hirer means the person who acquires or has acquired the possession of the goods from an owner under a hire purchase agreement, and includes a person to whom the hirer’s rights of liabilities under the hire purchase agreement have been passed by assignment or by operation of law.

4. Hire?
Hire means the amount payable periodically by the hirer, under the hire purchase agreement.

5. **Hire Vendor?**
Hire vendor or hire seller is the person who sells the goods on hire purchase system.

6. **the term cash price?**
Cash price or cash value of an asset is the price payable on the outright purchase of the asset.

7. **“Hire Purchase Price”?**
Hire purchase price is the price payable for the purchase of an asset on hire purchase system. It comprises the cash price of the asset plus in the interest payable on the unpaid balance of the cash price till the end of the period of hire purchase agreement.

8. **down payment?**
Down payment or advance payment means the advance paid or the cash payment made on the date of signing the hire purchase agreement.

9. **total interest?**
Total interest for all the installments is the total amount of interest for all the installments. It is the difference between of hire purchase price and the cash price of the asset.

10. **owner?**
Owner means the person who lets or has let delivers or has delivered possession of goods to a hirer under hire purchase agreement and includes a person to whom the owner’s property in the goods or any of the owner’s rights or liabilities under the agreement has passes by assignment or operation of law.

11. **hire purchase agreement?**
As per section 2 (c) of the hire purchase Act 1972, hire purchase agreement means an agreement under which goods are let or hire and under which the hirer has an option to purchase these goods let on hire in accordance with the agreement and also includes the following.
1. The possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments.
2. The property in the goods is to pass to such person on the payment of the last such installments and
3. Such a person has a right to terminate the agreement at any time before the property so passes.
1 Distinguish between Hire purchase and leasing

1. Ownership
2. Method of financing
3. Depreciation
4. Tax benefits
5. Salvage Value
6. Deposit
7. Rent-Purchase
8. Extent of finance
9. Maintenance
10. Reporting

1) Ownership:

In a contract of lease, the Ownership rests with the lessee 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:

Leasing, depreciation and investment allowance cannot be claimed by the lessee, in hire purchase, depreciation and investment allowance can be claimed by the hirer.

4) Tax Benefits:

The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

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 Salvage Value of the asset.

6) Deposit:

Lessee is not required to make any deposit whereas 20% deposit is required in hire purchase.

7) Rent – Purchase:

With lease, we rent and with hire purchase we buy the goods.

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 cost of the asset is to be paid by the hirer.

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 the lessee.

10) Reporting:

The asset on hire purchase is shown in the balance sheet of the hirer. The leased assets are shown by way of foot note only.

2) Enumerate the 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 of any installment the seller has right to reposes the goods from the buyer and forfeit the amount already received treating it as hire charge.
5. The hirer has the right to terminate the agreement any time before the property passes. There 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 sums already paid as such sums legally represent hire charge on the goods in question.

3) the condition to be fulfilled under Hire purchase Agreement?

According to the Hire Purchase Act 1972, on agreement which fulfills the following conditions, is a hire purchase agreement:

i. The possession of the goods is delivered by the owner there of to a person on condition that such person pays the agreed amount in periodic installments;
ii. The property in such goods is to pass to such a person on the payment of the last of such installment; and

iii. Such person has the right to terminate the agreement at any time before the property so passes.

Therefore the two distinct aspects of a hire purchase transaction are:

i. The option to purchase the goods at any time during the term of the agreement; and
ii. The right available to the hirer to terminate the agreement at any time before the payment of the last installment.

Thus, a hire purchase transaction is one where the hirer(user) has, at the end of the fixed term of hire an option to buy the asset at a taken value. In other words, financial leases with a bargain buyout option at the end of the term can be called a hire purchase transaction.

4) the problem of Hire purchase:

1) Taxation
2) Shortage of law-cost funds
3) Slow Market growth

4) Less Number of players

5) Increasing conservatism in the Market

1) Taxation:-
The leasing and hire purchase companies in India pay central Sales tax, Services tax of 5 per cent local sales tax of 4 per cent to 14 per cent and income tax. The industry has been asking for the removal of either sales or service tax of late, the government has recognized these activities as sale, and hence service tax on hire purchase or lease transactions is totally unjustifiable.

2) Shortage of low-cost funds:-
There is an acute shortage of low-cost funds available to hire purchase and leasing companies in the light of the stringent RBI norms. The industry feels that the banks are meeting out step-motherly treatment. This has squeezed the industry’s margins to the minimum.

3) Slow Market Growth:-
In 1997-98 the total base of leased assets in India in the formal market was estimated as US $ 37.0 billion. This value represents nominal growth of 7.6 per cent from 1996 – 97 when the value of leased assets totaled US $ 34.0 billion. The latter figure was up 20 per cent from US $ 28.5 billion in 1995 – 96.

4) Less Number of Players:-
Between 1991-94, when financial markets were booming, a large number of companies entered the leasing and hire purchase markets with little regard for the quality of clients. Since, 1996, with the market slowing, clients began defaulting on payments consequently, a number of lease financing companies faced a severe asset – liability mismatch, which led to a repayment crisis and bankruptcy.

5) Increasing conservatism in the Market:-
Since 1996, a most existing leasing company have become more conservative in their lending practices following the collapse of several leasing and hire purchase finance companies. Companies that were same what conservative to begin with have weathered the crisis and have become more conservative. The government in response to the above problems has begin to increase its regulation of the market to ensure better compliance and prudent business practices. The step-up in regulation induded stricter requirements for deposit mobilization, capital adequacy, and registration and de-registration of NBFCs and periodic performance reviews to ensure that only financially sound companies are in the market.

5) the features of Hire purchase:

The main features of a hire purchase arrangement are as follows:

1. The hire – vendor gives the asset on hire to the hirer.
2. The hirer is required to make down payment of around 20 per cent of the cost of the equipment and repay the balance in regular hire purchase installments over a specified period of time. These installments cover interest as well as the principal repayment. In some cases, the finance company that gives hire purchase finance insists that the hirer give a deposit, which may be around 20 percent of the cost of the asset. The deposit carries interest and is returnable at the end of the hire purchase period.
3. When the hirer pays the last installment, the title of the asset is transferred from hire vendor to the hirer.
4. The hire-vendor charges interest on a flat basis. This means that a certain rate of interest is charged on the initial investment and not on the diminishing balance.
5. During the currency of the contract the hirer can opt for an early repayment and purchase the asset. The hirer exercising this option is required to pay the remaining amount of hire purchase installments less on interest rebate.
6. Theoretically the hirer can exercise the cancelable option and cancel the contract after giving due notice to the finance company.
6) Distinguish between sale and Hire purchase.

1. In the case of a sale, the ownership of the goods passes from the seller to the buyer as soon as the contract of sale is over. But in the case of hire purchase, the ownership of the goods passes from the hire seller to the hire purchaser only after the last installment is paid.
2. In the case of a sale, if the purchase fails to pay the price of goods, the seller cannot take back the goods from the buyer as the ownership of the goods had been passed from the seller to the buyer on the date of sale itself. On the other hand, in the case of a hire purchase. If the hire purchaser, as the ownership of the goods is not passed on from the hire seller to the hire purchaser till last installment is paid.
3. In the case of a sale, generally, the goods cannot be returned by the buyer. But in the case of a hire purchase the goods can be returned by the hire purchaser to the hire seller before the ownership of the goods is passed on to him.
4. In the case of a sale, the price of the goods is generally, paid in one lump sum, either immediately or after sometime. But in the case of hire purchase the price of goods is paid, not in one lump sum, but in a number of installments.
5. In the case of a sale whether it is a cash sale or a credit sale, the purchaser is required to pay only the cash price of the goods. But in the case of a hire purchase, the hire purchaser is required to pay the cash price of the goods plus the interest for the various installments.
6. In the case of a sale, the buyer’s position is like that of an owner. But in the case of a hire purchaser position is like that of a bailee till the ownership of the goods is passed to him.

7) the contents of Hire purchase Agreement?

Every hire purchase agreement must be in writing. It must contain the following particulars
i. The hire purchase price of the goods
ii. The cost price of the goods
iii. The date on which the agreement commences.
iv. The number of installments and the amount of each installment, the dates on which the installments are payable and the person to whom and the place where are installments are payable.
v. The description of the goods covered by the hire purchase agreement if the hire purchase agreement contravenes this provision can rescind the agreement by instituting a suit. As in the case of sale of Goods Act, the hire purchase Act also implies certain conditions and warranties.

1. „Factoring“
Factoring is a method of financing where by a company sells its trade debts at a discount to a financial institution, factoring is a continuous arrangement between a financial institution.

2. forfaiting?

Forfaiting is the non-recourse purchase by a bank or any other financial institution, of receivables arising from an export of goods and service.

3. domestic factoring?

Factoring that arises from transaction relating to domestic sales is known as domestic factoring.

4. important functions of factoring

Factoring simply refers to the process of selling trade debts of the company to a institution. Factoring involves the following function.

i) Purchase and collection of debts.

ii) Sales ledger management

5. the players in the factoring arrangement?

The buyer, the seller, the factor are the players in the factoring arrangement.

6. “cross border factoring”?

“Cross border factoring” involves the claims of an exporter which are assigned to a banker or any financial institution in the importer’s country and financial assistance is obtained on the strength of the export documents and guaranteed payment.

7. types of export factoring

i) Two factor system

There two factors under the system one in the exporter’s country and other in the importers country.

ii) Single factor system

The export factor himself will do all the work. So it is called single factor system.

8. Edi factoring?

To assist international factoring, the FCI has developed a special communication system for its member called electronic data interchange factoring (Edi factoring).

9. “International Factoring”
“Factoring means an arrangement between a factor and his client which includes at least two of the following service to provide by the factor:
1. Finance
2. Maintenances of accounts
3. Collection of debts and
4. Protection against credit risks
10. Forfaiting.

Forfaiting has been defined as “the non resources purchase by a bank or any other financial institution, of receivable arising from an export of goods and service”.

11. advantages of factoring.
1. Leverage benefit – this advantage of factoring is that it helps improve the scope of operating leverage.
2. Enhanced return- factoring is considered attractive users as it helps enhanced return.

12. direct export factor system?

Under the system, there is a factoring agreement directly between the exporter and the exporter factor and no other party is involved. The entire export credit risk, the administration of the account, the advance payment etc. have to be done only by export factor. Hence it is called direct export factor system.

1. Explain the mechanism involved in factoring

Under the factoring arrangement, the seller does not maintain a credit or collection department. The job instead is handed over to specialized agency, called the „factor”. After each sale, a copy of the invoice and delivery challan, the arrangement and other related papers are handed over the factor. The factor, in turn, receives payment from the buyer on the due date as agreed, where by the buyer is reminded of the due determent account for collection. The factor remits the money collected to the seller after deducting and adjusting its own service charges at the agreed rate. Thereafter, the seller close all transactions with the. The seller passes on the paper to the factor for recovery of the amount.

2. Factoring in India
There are two factoring companies in public sector banks.

1. SBI factors and commercial service ltd.

2. Can bank factor ltd.

1. SBI Factor and commercial service ltd, was floated jointly by SBI, SIDBI and union bank of India in march 1991. This factory company has become an associate member of the factors chain international, based in Amsterdam. It also joined recently EDIFACT- which is a communication network of chain international of electronic data interchange.

2. Can bank factor ltd.

Can bank factor ltd was jointly promoted by canara bank, andra bank and SIDBI, in august 1992 to operate in south India. It paid up capital of Rs 10 cores is contributed in the ratio of 60:20:20 by its three promoters. It can have its operations throughout India due to the lifting up of restriction by RBI.

3. the characteristic features of factoring

The characteristic of factoring are as follows.

1. Bailment contract.

The nature of the factoring contract is similar to that of a bailment contract. Factoring is a specialized actively where by a firm converts its receivable into cash by selling them to a factoring organization.

2. Form of factoring

Factoring takes the form of a typical invoice factoring since it covers only those receivable which are not supported by negotiable instrument, such as bill of exchange etc.

3. Assignment of debts.

Under factoring, there is assignment of debt in favor of the factor. This is the basic requirement for working of factoring service.

4. Fiduciary position of factor.

The position of the factor is fiduciary in nature, since it arises from the relationship with the client firm.

5. Professional management.

Factoring firms are professionally competent, with skilled persons to handle credit sales realization for different client in different trade for better credit management.

4. the salient features of cross- border factoring?

The important features of this type of factoring is-

1. It is similar to export factoring, where important factor is engaged by the export factor at the debtors end.
2. It is also called „International Factoring” or the two factor system of factoring.

3. The parties involved are the exporter, the importer, and the export factor and the import factor.
4. There are two separate inter-linked agreements, between the exporter and the export factor on the one hand, and the export factor and the import factor on the other.
5. The export and the import factors belong to a formal chain of factors, with well defined rules governing the conduct of business.

5. the advantages and disadvantages of factoring?

Advantages
1. Cost saving

It also helps in reduction of administrative cost and burden, facilitating cost saving.
2. Leverage benefit

It helps import the scope of operating leverage.
3. Enhanced return

Factoring is considered attractive to users as it helps enhance return.
4. Liquidity

It helps to avoid increased debts in case of without recourse factoring.

Disadvantages
1. Engaging a factor may be reflective of the inefficiency of the management of the firm's receivable.
2. Factoring may be redundant if a firm maintain a nationwide network of branches.
3. Difficulties arising from the financial evaluation of clients.
4. A competitive cost of factoring has to be determined before taking a decision about engaging a factor.

6. the benefit of forfaiting

Following are the important benefit of forfaiting is:-
1. Profitable and liquid

It is very advantageous because he not only get immediate income in the form of discount charges, but also, can sell them in the secondary market or to any investor for cash.
2. Simple and flexible
It is also beneficial to the exporter. All the benefit that are available to a client under factoring are automatically available under forfeiting also.

3. Avoids export credit risk

The exporter is completely free from many export credit risks that may arise due to the possibility of interest rate fluctuation or exchange rates fluctuation or any political upheaval that may effect collection of bills.

4. Avoid export credit insurance

It is very costly and at the same time it involves very cumbersome procedures.

5. Cent percent finance

The export is able to convert his deferred transaction into cash transaction through a forfaitor. He is able to get 100 percent finance against export receivables”.

7. the three key element of factoring

There are three key elements of factoring:-

1. Selection of accounts.
2. Collection of accounts
3. Granting advance against receivable

1. Selection of accounts.

The factor selects accounts of a supplier to be bought on a continuous basis based on customer’s age, time of credit, quantum of amount etc. Normally the factor and the seller or supplier agree 1) on the credit limit for their customer, 2) the collection period and, 3) rebate to be charged.

2. Collection of accounts

The supplier or seller informs each customer that the factor has purchased the debt and the customer should pay only to the factor.

3. Granting advance against receivable

The factor generally advances a portion of the value of assigned debt. The balance amount is paid on maturity. By providing funds to the supplier, the factor enables him to resume production.

8. What is international factoring? Who are the parties” involved in it?
International factoring is the services of a factor in a domestic business are simply extended on the basis of the invoice prepared by the exporter. International factoring is facilitated with the help of export factors and import factors. 

In an international factoring transaction, there are four parties namely

1. The exporter who is taking the place of a client in a domestic transaction.
2. The importer who is taking the role of a customer in a domestic transaction.
3. Export factor.
4. Import factor.

The exporter and the factor enter into an agreement for export factoring may take any one of the following types:-

1. Two factor system

There are two factors under this system- one in the export"s country and other in the importer"s country. When the exporter wants to do business with some importer or importers, he approaches the factor in his country and informs him of his business proposal.

2. Single factor system

Export factor himself will do all the work. So it is called single factor system. The import factor is called upon to assist the export factor only during the times of difficulties in realizing debt.

3. Direct export system

Under this system, there is a factoring agreement directly between the exporter and this export factor and no other party is involved.

4. Direct import factor system

The agreement between the exporter and the import factor in the importer"s country.

9. the recommendation of Kalyansundaram committee.

Kalyansundaram committee was appointed in 1989 by RBI to study the feasibility of introducing factoring service in India. Accordingly in 1990 the recommendation of the committee were accepted, these are:-

☐ There is more scope for introducing factoring in India, especially through banks.
☐ Exporters can enjoy more benefits by factoring services.
☐ The growth of factoring will be so fast that within 2 or 3 years, it will be a viable business.
☐ Export factors can provide various other services also.
☐ All the industries as well as service can avail factoring service.
☐ Bank can take up factoring business due to their excellent network of branches.
10. Distinguish between factoring and forfaiting.

- Factoring is always used as a tool for short term financing where as forfaiting is for medium term financing at a fixed rate of interest.
- Factoring is generally employed to finance both the domestic and export business. But forfaiting is invariably employed in export business only.
- The central there of factoring is the purchase of the invoice of the client where it is only the purchase of the export bill under forfaiting.
- Forfaiting is done without recourse to the client where as it may or may not be so under factoring.
- The bills under forfaiting may be held by the forfaiting till the due date or they can be sold in the secondary market or to any investor for cash. Such a possibility does not exist under factoring.

UNIT-5 INTRODUCTION

INDIAN STOCK MARKET

Before liberalization, Indian economy was tightly controlled and protected by number of measures like licensing system, high tariffs and rates, limited investment in core sectors only. During 1980’s, growth of economy was highly unsustainable because of its dependence on borrowings to correct the current account deficit. To reduce the imbalances, the government of India introduced economic policy in 1991 to implement structural reforms. The financial sector at that time was much unstructured and its scope was limited only to bonds, equity, insurance, commodity markets, mutual and pension funds. In order to structure the security market, a regulatory authority named as SEBI (Security Exchange Board of India) was introduced and first electronic exchange National Stock Exchange also set up. The purpose behind this was to regularize investments, mobilization of resources and to give credit.

Mark Twain once has divided the people into types: one who has seen the great Indian monument, The Taj Mahal and the second, who have not. The same can be said about investors. There are two types of investors: those who are aware of the investment opportunities available in India and those who are not. A stock market is a place where buyers and sellers of stocks come together, physically or virtually. Participants in the market can be small individuals or large fund managers who can be situated anywhere. Investors place their orders to the professionals of a stock exchange who executes these buying and selling orders. The stocks are listed and traded on stock exchanges. Some exchanges are physically located, based on open outcry system where transactions are carried out on trading floor. The other exchanges are virtual exchanges whereas a network of computers is composed to do the transactions electronically. The whole system is order-driven, the order placed by an investor is automatically matched with the best limit order. This system provides more transparency as it shows all buy and sell orders. The Indian stock market mainly functions on two major stock exchanges, the BSE (Bombay Stock Exchange) and NSE (National Stock Exchange). In terms of market capitalization, BSE and NSE have a place in top five stock exchanges of developing economies of the world. Out of total fourteen stock exchanges of emerging economies, BSE stood at fourth position with market capitalization of $1,101.87b as on June, 2012 and NSE at fifth position with market capitalization of $1079.39b as on June, 2012.

Bombay Stock Exchange

Bombay Stock Exchange is located on Dalal street, Mumbai. In terms of market capitalization, BSE is the eleventh largest stock exchange in the world on 31st December, 2012. BSE is the oldest stock exchange in India. In the beginning during 1855, some stock brokers were gathering under Banyan tree. But later on
when the number of stock brokers increased, the group shifted in 1874. In 1875, the group became an official organization named as “The Native Chor and Stock Brokers Association”. In 1986, BSE developed its Index named as SENSEX to measure the performance of the exchange. Initially, there was an open outcry floor trading system which in 1995 switched to electronic trading system. The exchange made the whole transition in just fifty days. BSE Online Trading, known as BOLT is a automated, screen based trading platform with a capacity of 8 millions orders per day. BSE provides an transparent and efficient market for trading in equities, debentures, bonds, derivatives and mutual funds etc. It also provides opportunity to trade in the equities of small and medium term enterprises. About 5000 companies are listed in Bombay Stock Exchange. As on January 2013, the total market capitalization of the companies listed in BSE is $1.32 trillion. In terms of transactions handling, BSE Ltd. is world’s fifth exchange. As far as Index Options trading is concerned, BSE is one of the world’s leading exchanges. Some other services like risk management, settlement, cleaning etc. The purpose of BSE automated systems and techniques are to protect the interest of the investor, to stimulate market and to promote innovations around the world. It is the first exchange across India and second across world to get an ISO 9000:2000 certification.

National Stock Exchange
The National Stock Exchange is located in Mumbai. It was incorporated in 1992 and became a stock exchange in 1993. The basic purpose of this exchange was to bring the transparency in the stock markets. It started its operations in the wholesale debt market in June 1994. The equity market segment of the National Stock Exchange commenced its operations in November, 1994 whereas in the derivatives segment, it started it operations in June, 2000. It has completely modern and fully automated screen based trading system having more than two lakh trading terminals, which provides the facility to the investors to trade from anywhere in India. It is playing an important role to reform the Indian equity market to bring more transparent, integrated and efficient stock market. As on July 2013, it has a market capitalization above than $989 billion. The total 1635 companies are listed in National Stock Exchange. The popular index of NSE, The CNX NIFTY is extremely used by the investor throughout India as well as internationally. NSE was firstly introduced by leading Indian financial institutions. It offers trading, settlement and clearing services in equity and debt market and also in derivatives. It is one of India’s largest exchanges internationally in cash, currency and index options trading. There are number of domestic and global companies that hold stake in the exchange. Some domestic companies include GIC, LIC, SBI and IDFC ltd. Among foreign investors, few are City Group Strategic Holdings, Mauritius limited, Norwest Venture Partners FII (Mauritius), MS Strategic (Mauritius) limited, Tiger Global five holdings, have stake in NSE. The National Stock Exchange replaced open outcry system, i.e. floor trading with the screen based automated system. Earlier, the price information can be accessed only by few people but now information can be seen by the people even in a remote location. The paper based settlement system was replaced by electronic screen based system and settlement of trade transactions was done on time. NSE also created National Securities Depository Limited (NSDL) which permitted investors to hold and manage their shares and bonds electronically through demat account. An investor can hold and trade in even one share. Now, the physical handling of securities eliminated so the chances of damage or misplacing of securities reduced to minimum and to hold the equities become more convenient. The National Security Depository Limited’s electronically security handling, convenience, transparency, low transaction prices and efficiency in trade which is affected by NSE, has enhanced the reach of Indian stock market to domestic as well as international investors.

Stock Market Volatility
To invest money in stock market is assumed to be risky because stock markets are volatile. There is volatility in stock market because macro economic variables influence it and affect stock prices. These factors can affect a single firm’s price and can be specific to a firm. On the contrary, some factors
commonly affect all the firms. For example, when stock market crashed on September 2008, the price of almost all listed companies came down. Volatility is the variation in asset prices change over a particular time period. It is very difficult to estimate the volatility accurately. Volatility is responsible to make the stock market risky but it is this only which provides the opportunity to make money to those who can understand it. It gives the investor opportunity to take advantage of fluctuation in prices, buy stock when prices fall and sell when prices are increasing. So, to take advantage of volatility it is need to be understood well. If the performance of Indian stock market is seen during last 20 years, it is found that its all about only four years 2003-2007. Some people believe that investment in stock market for longer period is always give fair returns but that’s not true. According to one study, returns in September 2001 were just 49% higher as compared to returns in September 1991, a compound return that is even lesser as compared to the return on a saving bank account deposit. In the last five years, from 2007 till 2012, the total market returns are only 5.9% per year.

Source: capitalmind.in Fig 1.1: SENSEX Journey

The whole growth in stock market is attained during 2003 and 2007, besides this time period, the stock market has given only substandard returns. The scrip prices have high returns but overall stock market doesn’t raise much.

Volatility Index (VIX)
India VIX is a volatility index based on the index option prices of NIFTY. India VIX is computed using the best bid and ask quotes of the out-of-the-money near and mid-month NIFTY option contracts which are traded on the F&O segment of NSE. India

VIX indicates the investor’s perception of the market’s volatility in the near term. The index depicts the expected market volatility over the next 30 calendar days. i.e. higher the India VIX values, higher the expected volatility and vice-versa. Basu et. al. (2010) focused on explaining the merits and demerits of the volatility index (VIX). The Volatility Index (VIX) measures the implied volatility in the market using the price levels of the index options. The attractiveness of VIX stems from the fact that it is negatively correlated with the underlying index, and that it creates a new asset class which bases itself on non-directional volatility views.

Investor Sentiment and Volatility
Investor psychology plays an important role in the stock market. How an investor reacts to information and regulatory procedures of the market has an immediate effect on equity market which in turn brings volatility. Sehgal et. al. (2009) believed that better regulatory framework does influence investor sentiment especially with regard to legal provisions relating to corporate governance and investor grievance redressal mechanism. Investor sentiment and market returns were highly correlated and in fact influence each other and so with the volatility.

Causes of Volatility
There are number of factors which are contributing to stock market volatility. Some of these are as follows:
1.) Fear Factor: Fear is the reason because of which an investor can see to avoid losses. It can be few people opinion giving a trigger to sell. Fear of loss makes the investor vary defensive which results into selling. Others also feel the same and start selling at the larger level.
2.) Double –Dip Worries: There are two types of people risk taker and risk averse. Risk taker believes that market is going to be rise and there is positive signal in the market. On the other hand, risk averse feels that market can sink any time. So these mixed reactions in the equity market make it more volatile.
3.) Changes in Economic Policy: FOMC (Federal Open Market Committee) monetary policy has its influence in the market. The market receives a positive response when news arrives that Fed is going to expand its quantitative easing programme, on the contrary, negative sentiments cover the market on arriving the news of tapering of quantitative easing programme by Fed.

4.) Economic Crisis: Market reacts negatively to any major economic crisis, the more severe the crisis, the more strongly is reacted by the investors. Because of fear of loss, most of the investors start selling, and only few people take this as an opportunity to buy. Investors don’t go for fundamental and technical analysis of their portfolio instead they just got influenced by the negativity of economic crisis.

Capital Asset Pricing Model and Portfolio Returns
Capital Asset Pricing Model establishes the relationship between risks and returns in the efficient capital market. It is assumed that there is a combination effect of the parameter CAPM to determine the security/portfolio returns. Manjunatha and Mallikarjunappa (2009) showed in their study that there is variation in security returns but when beta is considered alone in the two parameter regressions, does not explain the variation in security returns.

Volatility in Indian Stock Market post liberalization
The high volatility is due to much foreign equity inflows. This results into dependence of Indian equity market on global capital market variations. It means any happening outside India will have its impact here as well. As when US economy was improving, resulted into falling rupee led negative sentiments to stock market crash. Domestic savings are lower which is increasing more foreign investments. According to RBI Handbook of Statistics (September, 2013), only 3.1% of incremental financial assets of household sector in fiscal year 2013 is invested in shares and debentures. Retail investor is participating less in equity market. Bank accounts consist of about 54% of the total household financial savings show that people want to invest less in risky assets. So, decline in domestic equity savings is biggest problem.

STOCK MARKET EFFICIENCY
It is general notion in the market that stock markets are efficient and prices reflect all available information. There is extensive research literature available to see whether stock markets are efficient or not. Some academicians believe that stock market is weak efficient (Cootner, 1962; Fama, 1965; Kendall, 1953; Granger & Morgenstern, 1970). While some others have belief that stock markets are not weak efficient (Chaudhary, 1991; Ranganatham & Subramanian, 1993). The present study is an attempt to see the efficient form of Indian stock market.

An ‘efficient’ market is defined as a market where there are large numbers of rational, profit ‘maximizes actively competing, with each trying to predict future market values of individual securities, and where important current information is almost freely available to all participants. In an efficient market, competition among the many intelligent participants leads to a situation where, at any point in time, actual prices of individual securities already reflect the effects of information based both on events that have already occurred and on events which, as of now, the market expects to take place in the future. In other words, in an efficient market at any point in time the actual price of a security will be a good estimate of its intrinsic value. (Fama, 1970)

Market efficiency is very important for any stock market because investment decisions of an investor are very much influenced by this. An investor can earn abnormal profits by taking benefit out of inefficient market whereas there is no scope of earning extra profits in an efficient market. The random walk hypothesis states that future prices are not predictable form the past. Successive price changes are not dependent over the past periods and past trends are not followed in future exactly. There is no information available in the market which is not reflected in the stock prices. Random walk basically means that prices vary randomly and there is not any significant pattern which followed in the market.
According to Jensen (1978), “A market is efficient with respect to information of it is impossible to make economic profits by trading on the basis of information.”
Malkiel (1992), “A capital market is said to be efficient if it fully and correctly reflects all relevant information in determining security prices. Formally, the market is said to be efficient with respect to some information, if security prices would be unaffected by revealing that information to all participants. Moreover, efficiency with respect to information implies that it is impossible to make economic profits by trading on the basis of information.”
Dyckman and Morse (1986) states that “A security market is generally defined as efficient if the price of the security traded in the market act as though they fully reflect all available information and these prices react instantaneously, or nearly so, and in unbiased fashion to new information”.

Types of Efficient Market Hypothesis
According to Fama (1965), Efficient Market Hypothesis suggests that security prices fully reflect all available information. There are three forms of efficient market hypothesis. These are as follows:

Weak Form Efficiency: This theory states that current prices reflect all past prices information which means if anyone has some extra ordinary information beyond this, he can earn profit by use of that information. It means that past information is reflected in stock price. Beyond past information, no information even publically available information can also have an impact on share price.

Semi-Strong Efficiency: The theory suggests that not only past prices are reflected in the current price but all publicly available information is also adjusted in the stock prices. It states that all relevant publicly available information is going to reflect in the stock price. It means if there is any new information reaches to the market, that is immediately digested by the market resulted into change in demand and supply and a new equilibrium level of prices is attained.

Strong Form of Efficiency: It states that current prices not only reflect publicly available information but insider information such as data given in company’s financial statements and company’s announcements etc. is also reflected in the present prices. For example, if company is planning to go for corporate restructuring in future, is also can’t be used by investor. All information is available to the investors and that is reflected to the market price. In normal circumstances what happens that if someone has nay private information then that person can make the profits by the use of that information by buying shares. He will continue doing that until this excess demand of shares will bring the price below, means no extra information. So he will stop to buy the shares and the stock price will be stable at the equilibrium level. This level is called strong form of market.

Efficiency and Market Returns
The all three forms of market efficiency have different consequences as far as excess returns are concerned:-

If market is weak-form efficient, no excess returns can be received on the basis of study of past prices. This type of study is called technical analysis which is based on the past prices study without any further information.

If market is semi-strong efficient, no excess returns can be received by the study of any publically available information. This study is called fundamental analysis, the study of companies, sectorals and the whole economy can’t produce much returns than expected compared to risk involved.

If market is strong-efficient, as prices are adjusted even for secret or privately held information so no excess return can be received even by insider trading.

SEASONAL ANOMALIES IN STOCK MARKET
“A seasonal price tendency is the propensity for a given market to move in a given direction at certain times of the year.” There is lots of research available which emphasized that seasonal anomalies lie in the stock market. There are different seasonal anomalies such as Monday effect or Friday effect or Day-of-the-week effect, Turn-of-the-month effect, Holiday effect, Semi-month effect, January Effect or December Effect or Month-of-the-year effect etc. Within these calendar anomalies, day-of-the-week effect and
month-of-the-year effect is analyzed under the present study. The day-of-the-week has its importance because it has its impact on the stock market volatility. If there is any king of seasonal patterns then the investor has the opportunity to take benefit out of it and earn abnormal profit.

Day-of-the-week effect
The Day-of-the-week effect means the average daily returns of all the days of the week are not the same. It is generally seen that Monday has a lower return as compared to other days Monday returns are on average lower than returns on other days known as Monday effect whereas Friday has higher returns as compared to returns of other days known as Friday effect (Cross, 1973; French, 1980; Gibbons & Hess, 1981, Jaffe & Westerfield, 1985). Fama (1965) documented that Mondays has 20% greater variances as compared to other days. There are different factors which cause day-of-the-week effect like settlement patterns, opening and closing of the market, ups and downs of the market, international factors, information etc. It is very difficult to consider any particular reason which is ultimate responsible for the seasonality in stock market. It is believed that investor prefers to sell more on Monday because he would like to adjust the impact of information received in prior week as generally bad news are released on Friday after the closing of the market. So, day-of-the-week effect is a normal practice which is observed in equity market and there is disparity on the issue whether calendar effects exist or not. 
Source: Jeremy J. Siegel “Stocks for the Long Run”
Fig 1.2: Monday Effect in DJIA

Month-of-the-Year Effect
“Monthly data provides a good illustration of Black's (1986) point about the difficulty of testing hypotheses with noisy data. It is quite possible that some month is indeed unique, but even with 90 years of data the standard deviation of the mean monthly return is very high (around 0.5 percent). Therefore, unless the unique month outperforms other months by more than 1 percent, it would not be identified as a special month.”(Lakonishok and Smidt, 1988). The seasonal anomaly is Month-of-the-Year effect. It means that returns in the market are not same for all the months of the year. According to one study in US, it is found that January has higher returns as compared to other months whereas December has lower returns (Rozeff and Kinnney, 1976; Gultekin and Gultekin, 1983; Keim, 1983).

January Effect
January Effect was first observed in 1942 by an investment banker Sidney B. Wachtel. The January effect means average stock prices are high in January month. The reason being is the tendency of the market where stock prices rise during last trading days in the month of the December and continue to rise in the month of January. It is believed that stock would be purchased at lower price in last days of December and sell the same at higher rates in January to earn profits.

Source: Ibbotson
Fig 1.3: January Effect in S&P 500

Causes of January Effect
Tax-Loss Selling: Stock prices come down in December because of tax reasons as some investors sell their stock in the year end to show capital loss and the same money is reinvested in the first months of the coming year (Jones, Lee & Apenbrink, 1991; Poterba & Weisbenner, 2001; Dai, 2003).
Bonus Payments: Bonus is paid by the corporate at the end of the year and the same money is used to purchase stock in the first month of year driving prices high.
Investor Psychology: Investor psychology is also playing an important role. The new year is assumed to be a new start to invest money in the market resulting higher stock prices.

Window Dressing: According to Window Dressing developed by Haugen & Lakonishok (1988), mutual fund managers sell stocks which have not performed well during the year so that they can reduce bad investments from their portfolio.

December Effect
There is evidence that traders have started purchasing some beaten up shares at the end of the year in expectation of market rise in new year. So, December is also an important month of the year, known as December Effect.

October Effect
October is treated as lowest returns month as if we look at the history it is seen that major crashes happened in October. The great depression of 1930’s started on October 29, 1929, known as black Tuesday, the day when DJIA (Dow Jones Industrial Average) declined 12% in a single day. October 19, 1987 known as Black Monday, DJIA (Dow Jones Industrial Average) declined 23%. October 13, 1989, DJIA (Dow Jones Industrial Average) declined 7% in the last hours of trading. Although, there is not any reason that why October is considered as bad month as some other months like September, 2008 when Lehman Brothers failed on March, 2000 crashed in NASDAQ market are also proved to be bad months. The present study is an attempt to identify the day-of-the-week effect and month-of-the-year effect in Indian stock market. Generally, markets have high returns during summer months, while in September, returns are less. During October, average returns are positive except in few cases like a record fall of -1.7% in 1929 and -21.5% in 1987.

Source: Ibbotson
Fig 1.4: September Effect in S&P 500

INDIAN AND INTERNATIONAL STOCK MARKETS
In the present era of liberalization, privatization and globalization, the international investments and diversification of portfolio internationally is an important issue, especially in the time period when stock markets are highly volatile. Normally, people invest in the stock market with the purpose of earning returns. An investor designs his portfolio in which he includes different stocks or group of stock on sectoral basis to achieve his purpose of maximum returns with minimum risk. International diversification can be an option as rationale behind this is that stock returns within a county can be highly correlated because of similar environment but internationally conditions can be different. On account of different factors like economic condition, political stability, tax and tariff rates and inflationary conditions, there are chances that less correlation in stock returns across different countries is possible.

In recent years, the interest in country fund especially in emerging economies has increased. Emerging markets are an attractive place for investment because of various reasons like open market system, liberal guidelines towards Foreign Direct Investment and Foreign Institutional Investment. At the time of allocation of the funds in internationally diversified portfolio, an investor would like to compare returns and risk across different countries. The benefit of internationally diversified portfolio can be enjoyed only when there is less correlation between international stock markets. Further, while constructing internationally diversified portfolio of securities, the correlation in the returns of stocks from two different countries required to be calculated. According to a report by Morgan Stanley, Indian markets are about three times more volatile as compared to other emerging markets and almost five times more than the volatility in developed markets. Other emerging markets such as China, Brazil and Russia have very less volatility in comparison to Indian market.
Contribution of Developed and Emerging Economies in Financial Crisis: A Controversial Issue

After Financial Crisis, whether the integration between emerging and developed economies has increased or not, this issue is always get attention from researchers and academicians. Few studies are in favor that integration between developed and emerging economies has increased after the financial crisis. Bahng (2003), who found that the influence of other Asian markets has increased on Indian stock market during and after the Asian Financial Crisis, this result gives an indication that Indian stock market, is moving closer towards other Asian stock markets integration. Wong et al., (2004) highlighted that there was a trend of increasing interdependence between most of developed markets and emerging markets after the 1987 market crash. After the 1997 financial crisis, the interdependence between these have gone more intensified resulted into international diversification benefits reduction. Bose (2005), found whether there are any common forces which driving the stock index of all economies or there was some country specific factors which controlling the each individual country’s economy. Indian stock market returns were highly correlated with the returns of rest of Asia and US during post Asian crisis and till mid 2004. Not only this, Indian stock market influenced some major Asian stock market returns. Co-integration between India and other market in Asian region was not very high but sufficient enough to design portfolio internationally. Huang (2013), supported that after Asian financial crisis from 1997-1999, the stock markets integration not getting weekend rather it improved and getting stronger.

Emerging and Developed economies Indices
A brief introduction of some indices from emerging economies and developed economies is given as follow:

**DJIA (Dow Jones Industrial Average)**
The Dow Jones Industrial Average is an index which is created by Wall Street Journal editor and Dow Jones & Company co-founder Charles Dow. It is at present owned by S&P Dow Jones Indices. It was first published on February 16, 1885. The averages are named after the name of Charles Dow and one of his business associates, statistician Edward Jones. It shows how 30 large publicly owned companies based in the United States have done in trading during a standard trading session in the stock market. Dow Jones Industrial Average is the second oldest U.S. market index after the Dow Jones Transportation Average. The Industrial part of the name is largely chronological, as most of new modern 30 companies have little or nothing to do with traditional heavy industry.

**DAX (Deutscher Aktien IndeX)**
The DAX is a blue chip German stock market index of Frankfurt Stock Exchange which consist of the 30 major German companies. DAX measures the performance of the Prime Standard’s 30 largest German companies by their volume and market capitalization. It is the alike FT30 and the Dow Jones Industrial Average, but because of its small assortment it does not essentially represent the economy as whole.

**HangSeng**
The HangSeng Index is a free float-adjusted market capitalization index. It is a weighted stock market index in Hong Kong. It is basically used to record and observe daily variation in the prices of the largest companies of the Hong Kong equity market. In Hong Kong, this is the main indicator of the overall market performance in Hong Kong. The 48 component companies of Hang Seng represent about 60% of market capitalization of the Hong Kong Stock Exchange. It was started on November 24, 1969, and Hang Seng...
Indices Company Limited is currently maintaining and compiling the index. Hang Seng Indices Company Limited is a wholly owned subsidiary of Hang Seng Bank, which is one of the largest banks listed in Hong Kong in terms of market capitalization.

RTSI (Russia Trading System)
The RTS Index (Russia Trading System) is a free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow Exchange in Moscow, Russia. The RTS Information Committee reviews the list of stocks in every three months. The RTS Index value is calculated in a real-time mode. The index was introduced on September 1, 1995 with a base value of 100. In addition to the RTS Index, MICEX-RTS also computes and publishes the RTS Standard Index (RTSSTD), RTS-2 Index, RTS Siberia Index and seven sectoral indices (Telecommunication, Financial, Metals & Mining, Oil & Gas, Industrial, Consumer & Retail, and Electric Utilities). The RTS Standard and RTS-2 are compiled similarly to the RTS Index, from a list of top 15 large-cap stocks and 50+ second-tier stocks, respectively.

S&P BSE SENSEX
The Bombay stock exchange most popular index is S&P BSE SENSEX, the sensitive index is also known as BSE30. It is a index which is free-float and market weighted stock market index. BSE consist of 30 companies which are well settled and financially very strong. These companies are large and very actively traded stocks comprise different industrial sectors of the Indian economy. SENSEX from its inception has become the major indicator to see the health of Indian equity market.

The base value of S&P BSE SENSEX was decided to be 100 on 1st April. 1979 and the base year taken was 1978-79. The free-float market capitalization of BSE was US$240 billion the 21st April, 2011. During the period of 2008-12, S&P BSE SENSEX market capitalization reduced from 49% to 25% because some other indices were introduced like BSE PSU, Bankex, BSE-TECK etc.

The 30 companies constituted BSE SENSEX index are continually assessed and changed according to changes in their position so that it can indicates the true market conditions. SENSEX is calculated by the use of method free float capitalization. Its different from traditional method in the sense that in free float market capitalization method, at a particular point of time, it reflects free float market value of the 3o companies proportional to the base year. To calculate the market capitalization of a company, the price of the company’s share is multiplied by the number of the shares.

FTSE Straits Times Index (STI)
The FTSE Straits Times Index (STI) is a benchmark index for the Singapore equity market. It consists of 30 companies listed on the Singapore stock exchange. It is calculated by Singapore Press Holdings, FTSE and Singapore Exchange. STI has been replaced from STII (Straits Times Industrials Index) when there was a sectoral reclassification of the companies listed in the Singapore Exchange and resulted in the removal of industrial category. STI started trading on August 1998 when STI left off.

FTSE 100
The FTSE 100 Index, also called FTSE 100, FTSE, is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. It is one of the most widely used stock indices and is seen as a gauge of business prosperity for business regulated by UK company law. The index is maintained by the FTSE Group, a subsidiary of the London Stock Exchange Group. The index began on 3 January 1984 at the base level of 1000; the highest value reached to date is 6950.6, on 30 December 1999. The FTSE 100 consists of the largest 100 qualifying UK companies by Total market value. The constituents of the index are determined quarterly, on the Wednesday after the first Friday of the month in March, June, September and December.

Nikkei 225
The Nikkei 225 more commonly called the Nikkei, the Nikkei index, or the Nikkei Stock Average is a stock market index for the Tokyo Stock Exchange (TSE). It has been calculated daily by the Nihon Keizai Shimbun (Nikkei) newspaper since 1950. It is a price-weighted index (the unit is yen), and the components are reviewed once a year. Currently, the Nikkei is the most widely quoted average of Japanese equities, similar to the Dow Jones Industrial Average. In fact, it was known as the "Nikkei Dow Jones Stock Average" from 1975 to 1985. The Nikkei 225 began to be calculated on September 7, 1950, retroactively calculated back to May 16, 1949. Since January 2010 the index is updated every 15 seconds during trading sessions.

**BOVESPA**

The BM&FBOVESPA is a stock exchange located at São Paulo, Brazil. On May 8, 2008, the São Paulo Stock Exchange (Bovespa) and the Brazilian Mercantile and Futures Exchange (BM&F) merged, creating BM&FBOVESPA. The benchmark indicator of BM&FBOVESPA is the Índice Bovespa. There were 381 companies traded at Bovespa as of April 30, 2008. On May 20, 2008 the Ibovespa index reached its 10th consecutive record mark closing at 73,516 points, with a traded volume of USD 4.2 billion or R$ 7.4 billion.

**AORD**

January 1980, the All Ordinaries (colloquially, the "All Ords"; also known as the All Ordinaries Index, AOI) is the oldest index of shares in Australia, so called because it contains nearly all ordinary (or common) shares listed on the Australian Securities Exchange (ASX). The market capitalization of the companies included in the All Ords index amounts to over 95% of the value of all shares listed on the ASX. The 3-letter exchange ticker in Australia for the All Ordinaries is "XAO". When established, the All Ords had a base index of 500; this means that if the index is currently at 5000 points, the value of stocks in the All Ords has increased tenfold since January 1980, not factoring in inflation.

**Shanghai Composite Index**

The SSE Composite Index is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. SSE Indices are all calculated using a Paasche weighted composite price index formula. This means that the index is based on a base period on a specific base day for its calculation. The base day for SSE Composite Index is December 19, 1990, and the base period is the total market capitalization of all stocks of that day.

**LITERATURE REVIEW**

Extensive researches have been done to know whether Indian stock market is volatile or not. In recent era of globalization and liberalization, the interdependence of various stock markets on each other has increased. Different factors not only national but international will increase the volatility in the market and hence the returns will also change. Lots of studies are available on this issue, support that Indian stock market volatility is persistent and spillover is present. The present study is done to fill this gap and to know the stock market volatility patterns in India. Some studies are in the favor that conditional volatility models whether symmetric or asymmetric, are able in capturing the stock market volatility.

**Conditional Volatility Models**

Karmakar (2005) estimated conditional volatility models in an effort to capture the salient features of stock market volatility in India. It was observed that GARCH model has been fitted for almost all companies. The various GARCH models provided good forecasts of volatility and are useful for portfolio allocation, performance measurement, option valuation etc. Because of the high growth of the economy and increasing interest of foreign investors towards the country, it is important to understand the pattern of stock market volatility to India which is time varying persistent and predictable. Banerjee and Sarkar (2006) attempted to model the volatility in the Indian stock market. It was found that the Indian stock
market experiences volatility clustering and hence GARCH type models predict the market volatility better than simple volatility models, like historical average, moving average etc.

Finally, it was seen that the change in volume of trade in the market directly affects the volatility of assets returns.

Kumar (2006) evaluated the ability of ten different statistical and econometric volatility forecasting models to the context of Indian stock and forex markets. These competing models were evaluated on the basis of two categories of evaluation measures – symmetric and asymmetric error statistics. Based on an out - of - sample forecasts and using a majority of evaluation measures find that GARCH methods will lead to Netter volatility forecasts in the Indian stock market and GARCH will achieve the same in the forex market. All the measures indicated historical mean model as the worst performing model in the forex market and in the stock market.

Karmakar (2007) investigated the heteroscedastic behaviour of the Indian stock market using different GARCH models. First, the standard GARCH approach was used to investigate whether stock return volatility changes over time and if so, whether it was predictable. Then, the E-GARCH models were applied to investigate whether there is asymmetric volatility. It was found that the volatility is an asymmetric function of past innovation, rising proportionately more during market decline.

Bordoloi and Shankar (2010) explored to develop alternative models from the Autoregressive Conditional Heteroskedasticity (ARCH) or its Generalization, the Generalized ARCH (GARCH) family, to estimate volatility in the Indian equity market return. It was found that these indicators contain information in explaining the stock returns. The Threshold GARCH (T-GARCH) models explained the volatilities better for both the BSE Indices and S&P-CNX 500, while Exponential GARCH (E-GARCH) models for the S&P CNX-NIFTY.

Srinivasan and Ibrahim (2010) attempted to model and forecast the volatility of the SENSEX Index returns of Indian stock market. Results showed that the symmetric GARCH model performed better in forecasting conditional variance of the SENSEX Index return rather than the asymmetric GARCH models, despite the presence of leverage effect. Few are against conditional volatility models. Pandey (2005) believed that there have been quite a few extensions of the basic conditional volatility models to incorporate observed characteristics of stock returns. It was found that for estimating the volatility, the extreme value estimators perform better on efficiency criteria than conditional volatility models. In terms of bias conditional volatility models performed better than the extreme value estimators.

Kumar and Gupta (2009) investigated and identified the adequate densities for fitting distribution of first difference of change in log prices of stocks. Four different ways were adopted to test whether the first difference of log of daily closing prices follows normal or Gaussian distribution. These provided strong evidence against Gaussian hypothesis for return distributions and fat tails are observed.

**Relationship between Return and Volatility**

Volatility is a measure of deviation from the mean return of a security. Volatility is measured by standard deviation. When the fluctuation in prices is large, standard deviation would be high and when there is less variation in prices, standard deviation would be less. Generally, higher the risk, higher is the chances of less than expected return. If volatility increases return decreases. Stock returns are uncertain because there is volatility in stock prices. Mahajan and Singh (2008) examined the empirical relationship between

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volume and return, and volume and volatility in the light of competing hypothesis about market structure by using daily data of Sensitive Index of the Bombay Stock Exchange. Consistent with mixture of distribution hypothesis, positive contemporaneous relationship between volume and volatility was observed.

Mubarik and Javid (2009) investigated the relationship between trading volume and returns and volatility of Pakistani market. The findings suggested that there was significance effect of the previous day trading volume on the current return and this implied that previous day returns and volume has explanatory power in explaining the current market returns.

Pandian and Jeyanthi (2009) made an attempt to analyze the return and volatility. It was found that the outlook for India is remarkably good. Bank, corporate and personal balance sheets are strong. Corporations are experiencing high profits. The stock market is at a record high. Commodity markets are at their strongest.

Abdalla (2012) discussed stock return volatility in the Saudi stock market. Results provided evidence of the existence of a positive risk premium, which supported the positive correlation hypothesis between volatility and the expected stock returns.

Nawazish and Sara (2012) examined the volatility patterns in Karachi Stock Exchange. They proposed that higher order moments of returns should be considered for prudent risk assessment. While there are some who believe that there is not much significant relationship between returns and volatility.

Léon (2008) studied the relationship between expected stock market returns and volatility in the regional stock market of the West African Economic and Monetary Union called the BRVM. The study revealed that expected stock return has a positive but not statistically significant relationship with expected volatility and volatility is higher during market booms than when market declines.

Karmakar (2009) investigated the daily price discovery process by exploring the common stochastic trend between the NIFTY and the NIFTY future based on vector error correction model (VECM). The results are that the VECM results showed the NIFTY futures dominate the cash market in price discovery.

Madhavi (2014) proved that stock market plays a very important role in the Indian economy. The economy directions can be measured by how the volatility index moves. Although financial industry affected by the financial crisis so stock market is perceived to be very risky place. But still, CAPM, Portfolio Diversification and APT always proved to be effective to manage the risk of market.

Time varying volatility and Negative Innovations

Mehta and Sharma (2011) focused to examine the time varying volatility of Indian stock market specifically in equity market. The findings of the study documented that the Indian equity market has witnessed the prevalence of time varying volatility where the past volatility has more significant impact on the current volatility.

Joshi (2010) investigated the stock market volatility in the emerging stock markets of India and China. The findings revealed that the persistence of volatility in Chinese stock market is more than Indian stock market.

Gupta et. al. (2013) aimed to understand the nature and different patterns of volatility in Indian stock market on the basis of comparison of two indices which are BSE index, SENSEX and NSE index, NIFTY. GARCH models were used to see the volatility of Indian equity market and it was concluded that negative
shocks do have greater impact on conditional volatility compared to positive shocks of the same magnitude in both indices i.e. SENSEX and NIFTY of the Bombay Stock Exchange and National Stock Exchange.

Volatility after the Introduction of Derivatives

Mallikarjunappa and Afsal (2008) studied the volatility of Indian stock market after the introduction of derivatives. Clustering and persistence of volatility was seen in volatility before and after the introduction of derivatives and the nature of volatility patterns altered after the derivatives.

Gahan et al. (2012) studied the volatility pattern of BSE Sensitive Index (SENSEX) and NSE Nifty (Nifty) during the post derivative period. The various volatility models were developed in the present study to get the approximately best estimates of volatility by recognizing the stylized features of Stock market data like heteroscedasticity, clustering, asymmetry autoregressive and persistence. When compared, it was found that there was difference between the volatility of pre and post derivative period. Conditional volatility determined under all the models for SENSEX and Nifty were found to be less in post derivative period than that of the post derivative period.

So, there is a gap whether there is any relationship in return and volatility as well as to see whether volatility is time varying or not. To fill this gap, the present study is done. This gives the formulation of first objective which is to see the patterns of volatility (with conditional volatility models) in Indian stock market and the effect of introduction of derivatives on stock market volatility.

Weak-Form Efficiency of Indian Stock Market

Efficiency of stock market has its implications for the whole economy and economic development of any country. As, if stock market is efficient enough then there is no need of government interference in the market movements. But, on the other side, in an inefficient market investor would like to take the benefit of extra ordinary information available to them. The role of government and the regulators increase in this situation to keep a control on significant high differences in the stock prices. Lots of research work has been done to know the efficiency of Indian stock market. Some studies are supporting that Indian stock market are not weak form efficient. Poshakwale (1996) provided evidence of day of the week effect and that the stock market is not weak form efficient. The day of the week effect observed on the BSE pose interesting buy and hold strategy issues.

Azarmi et. al. (2005) examined the empirical association between stock market development and economic growth for a period of ten years around the Indian market “liberalization” event. The data suggested that stock market development in India is not associated with economic growth over a twenty-one year study period. The results were consistent with the suggestion that the Indian Stock market is a casino for the sub-period of post liberalization and for the entire ten-year event study period.

Gupta and Basu (2007) explained that hypothesis of market efficiency is an important concept for the investors who wish to hold internationally diversified portfolios. With increased movement of investments across international boundaries owing to the integration of world economies, the understanding of efficiency of the emerging markets is also gaining greater importance. The evidence suggested that the series do not follow random walk and there is an evidence of autocorrelation in both markets rejecting the weak form efficiency hypothesis.

Chander et al. (2008) documented extensive evidence on price behavior in the Indian stock market. The random behavior of stock prices was quite visible, but could not undermine the noted drifts because randomness alone does not signify weak form market efficiency and vice-versa.

Singh (2008) studied some of the issues related to the estimation of beta. It was found that beta varies considerably with method of computation and the major reason for variation seems to be the interval
between data points. While the correlation between weekly and daily betas was very high, this was not the case with weekly and monthly betas. The variability of betas was higher with longer interval periods and more stocks were classified as aggressive when monthly returns were used.

Srinivasan (2010) examined the random walk hypothesis to determine the validity of weak-form efficiency for two major stock markets in India. He suggested that the Indian stock market do not show characteristics of random walk and was not efficient in the weak form implying that stock prices remain predictable.

Khan et al. (2011) proposed that testing the efficiency of the market is an important concept for the investors, stock brokers, financial institutions, government etc. Based on the result of runs test alternate hypothesis was rejected and it was proved that Indian Capital market neither follow random walk model nor is a weak form efficient.

Jethwani and Achuthan (2013) investigated the weak form efficiency during, before and after Financial Crisis which took place in the year 2002 (Dot Com Bubble) and 2007 (Sub Prime Crisis). The result shows that Indian stock market is not weak form efficient in all periods however after 2002 stock market behaves in more efficient manner.

On the other hand, some studies reflect that Indian stock market is weak form efficient and no investor has the option to take benefit of this. Sehgal and Gupta (2007) discussed that technical indicators do not outperform Simple Buy and Hold strategy on net return basis for individual stocks. Technical indicators seemed to do better during market upturns compared to market downturns. The empirical results suggested that technical analysis provides statistically significant returns for the entire nine technical indicators on gross return basis during the entire study period.

Gupta (2010) briefed that the behavior of stock returns has been extensively debated over the past few years. The validation of random walk implied that market is efficient and current prices fully reflect available information and hence there was no scope for any investor to make abnormal profits. The result of the study indicated that the Indian stock market are weak form efficient and follow random walk.

Singh et al. (2010) aimed to present theoretical framework of efficiency of stock markets and test the Indian stock market for weak form efficiency. Statistically, the study shows that Indian stock market is weak form efficient and price changes follow a random walk.

Aggarwal (2012) emphasized that weak form of efficient market hypotheses is an area of attraction for researchers and academicians as proved by numerous studies investigating efficient market phenomenon at global level. It was found that Indian markets are random and successive index value changes are independent. The past index changes do not help the investor or analyst to forecast the future.

Rehman et al. (2012) explained that how they tested the weak-form efficiency of emerging south Asian stock markets i.e. Karachi Stock Exchange of Pakistan, Bombay Stock Exchange of India and Colombo Stock Exchange (CSE) of Sri Lanka. It was found that CSE is the Weak form efficient market.

Loomba (2012) attempted to develop an understanding of the dynamics of the trading behaviour of FIIs and effect on the Indian equity market. The study provided the evidence of significant positive correlation between FII activity and effects on Indian Capital Market. The analysis also found that the movements in the Indian Capital Market are fairly explained by the FII net inflows.
Mobarek and Fiorante (2014) determined whether the equity markets of Brazil, Russia, India and China (BRIC) may be considered weak-form efficient in recent years. The major findings indicated that the results from the last sub-periods, including the subprime crisis, support the belief that these markets may have been approaching a state of being fairly weak-form efficient, which reflects the future prospects of BRIC countries.

Bhat et. al. (2014) focused on analyzing and comparing the efficiency of the capital markets of India and Pakistan. The results derived by using various parametric and non-parametric tests clearly reject the null hypothesis of the stock markets of India and Pakistan being efficient in weak form. The study provides vital indications to investors, hedgers, arbitragers and speculators as well as the relevance of fundamental and technical analysis as far as the trading/investing in the capital markets of India and Pakistan is concerned. A gap is seen between the studies as some are in favor that Indian stock market are weak form efficient while other are against it, so this gap helped in formulating the another objective which is to seek the weak form efficiency of Indian stock market.

Seasonality in Indian Stock Market
Seasonal anomalies are a regular practice to be seen in equity market. Extensive research is being conducted to understand this. Some of the studies are supporting that there are seasonal anomalies existing in Indian stock market. Berument and Kiymaz (2001) tested the presence of the day of the week effect on stock market volatility by using the S&P 500 market index. The findings showed that the day of the week effect was present in both volatility and return equations.

Kiymaz and Berument (2003) investigated the day of the week effect on the volatility of major stock market indexes. It was found that the day of the week effect was present in both return and volatility equations. The highest volatility occurred on Mondays for Germany and Japan, on Fridays for Canada and the United States, and on Thursdays for the United Kingdom. For most of the markets, the days with the highest volatility also coincided with that market’s lowest trading volume.

Sarma (2004) explored the day-of-the-week effect on the Indian stock market returns in the post-reform era. The Monday-Tuesday, Monday-Friday, and Wednesday-Friday sets had positive deviations for all the indices. It was concluded that the observed patterns were useful in timing the deals thereby explored the opportunity of exploiting the observed regularities in the Indian stock market returns.

Chan et al. (2004) proposed that Monday seasonal is stronger in stocks with low institutional holdings and that the Monday return is not significantly different from the mean Tuesday to Friday returns for stocks with high institutional holdings during the 1990–1998 period. The study provided direct evidence to support the belief that the Monday seasonal may be related to the trading activities of less sophisticated individual investors.

Chander and Mehta (2007) emphasized that investors and analysts are unable to predict stock price movements consistently so as to beat the market in informationally efficient markets. It was seen whether anomalous patterns yield abnormal return consistently for any specific day of the week even after introduction of the compulsory rolling settlement on Indian bourses. The findings recorded for post-rolling settlement period were in harmony with those obtained elsewhere in the sense that Friday returns were highest and those on Monday were the lowest.

Chia and Liew (2010) studied the existence of day-of-the-week effect and asymmetrical market behavior in the Bombay Stock Exchange (BSE) over the pre-9/11 and post-9/11 sub-periods. They found the existence of significant positive Monday effect and negative Friday effect during the pre-9/11 sub-period. Moreover, significant day-of-the-week effect was found present in BSE regardless of sub-periods, after controlling for time-varying variance and asymmetrical market behavior.
Keong et al (2010) investigated the presence of the month-of-the-year effect on stock returns and volatility in eleven Asian countries- Hong Kong, India, Indonesia, Japan, Malaysia, Korea, Philippines, Singapore, Taiwan, China and Thailand. Results obtained exhibit positive December effect, except for Hong Kong, Japan, Korea, and China. Meanwhile, few countries do have positive January, April, and May effect and only Indonesia demonstrates negative August effect.

Sah (2010) believed the main cause of seasonal variations in time series data is the change in climate. The study found that daily and monthly seasonality were present in NIFTY and NIFTY Junior returns. It was found that Friday Effect in NIFTY returns while NIFTY Junior returns were statistically significant on Friday, Monday and Wednesday. In case of monthly analysis of returns, the study found that NIFTY returns were statistically significant in July, September, December and January.

Sewraj et al (2010) investigated the day of the week effect, more precisely the Monday effect and the January effect on the Stock Exchange of Mauritius (SEM) in order to get the information whether these anomalies exist or not. The result showed that Monday effect was nonexistent in SEM. It was found that a significant positive January effect is present at market level.

Swami (2011) investigated four calendar anomalies, viz., Day of the Week effect, Monthly effect, Turn of the month effect and Month of the year effect across five countries of South Asia. The day of the week effect, was found to exist in Sri Lanka and Bangladesh; and the intra-month return regularity, in terms of Monthly effect and Turn of the month effect, was present in the Indian market. The anomalous behavior was not pervading across the five countries and there was little influence of one market over the other, so far as calendar anomalies were concerned.

Anuradha and Rajendran (2012) attempted to investigate whether the Foreign Institutional Investment (FII) in Indian capital market has any calendar effect in net FII(NFII), net FII in equity(EFII) and net FII in debt(DFII). After 2003, November effects were also present in both the series in addition to February effect in net FII and in equity. In the case of DFII, January effect has reappeared which has started in the month of December itself. Since the equity market was so efficient and volatile, the FII have chosen the debt instruments for assured returns. When checked for the monthly seasonality in market return, January effect is present in the first period. During the early stages of opening the market to the global players (after 1992 but before 2003), the market itself was in a developing stage and slightly in the weak form of inefficiency. That is the reason for the January effect in the first period of the study. But later on the effect has disappeared leading to the conclusion that the market has become efficient, making abnormal returns impossible. Also there exists interaction influence on the NFII in the recent period.

Siddiqui and Narula (2013) investigated the persistence of such regularities in the form of weekend effect, monthly effect and holidays effect employing twelve-year data from 2000 to 2011 of S&P CNX Nifty. The results indicated the occurrence of weekend effect in long run but reject the hypothesis of positive weekends and negative Mondays. On the contrary, the mean return on Tuesday is negative for the entire period. Instead of March effect, the study comes out with November effect and hence nullifies the ‘Tax-Loss Selling Hypothesis’. On dividing the entire period into three-year lags, anomalies instantaneously disappear confirming the fact that any seasonality takes some time to establish itself.

Sharma and Deo (2014) studied existence of the January Effect and Turn of the month year effect in the Indian stock markets. The significant April month was found and the return of March was significantly lower. This was the result of tax-loss hypothesis.
Maheta (2014) carried out this study to measure effect of festivals on the return of selected stock indices of Indian stock market. The researcher took the closing price of two indices i.e. Sensex and Nifty from January 2003 to December 2012 and applied paired t test on daily return series. The main findings of this paper are there is significant influence of festivals like Holi, Janmashtami and Diwali on the mean return of selected indices.

Few studies are not supporting that seasonal anomalies i.e. day of the week effect and month of the year effect is not present in Indian stock market. Pandey (2002) examined the presence of the seasonal or monthly effect in stock returns in Indian stock market. The statistically significant coefficient for March- the month for tax payment- was consistent with the tax-loss selling hypothesis. It was implied that

the stock market in India was not informationally efficient, and hence, investors can time their share investments to earn abnormal returns.

Kaur (2004) investigated the nature and characteristics of stock market volatility in Indian stock market in terms of its time varying nature, presence of certain characteristics such as volatility clustering, day-of-the-week effect and calendar month effect and whether there existed any spillover effect between the domestic and the US stock markets. It showed that day-of-the-week effect or the weekend effect and the January effect were not present.

Deb et. al. (2007) attempted to explore the market timing ability and the stock selection ability of the Indian mutual fund managers. In both traditional and conditional models it is found that there is very little evidence of market timing, particularly using the monthly data frequency. It was observed that, while the number of positive timers marginally increased, there was no improvement in the number of significant positive timers.

Mittal and Jain (2009) found that the anomalies don’t exist in the Indian stock market and this market can be considered as informationally efficient. It means that it is not possible to earn abnormal returns constantly that are not commensurate with the risk. Although the mean returns on Mondays were negative whereas the mean returns on Fridays were positive but T-test results concluded that there was insignificant difference between the returns on Monday and other week days. The Friday effect was also found insignificant while comparing Friday returns with other day’s mean returns.

Abdalla (2012) investigated the day of the week effect anomaly on stock market returns and the conditional volatility of the Khartoum stock exchange (KSE) from Sudan. The results indicated that the day of the week effect was not influenced by the stock market risk based on using GARCH-M (1,1) model.

Nageswari and Selvam (2012) investigated whether Friday effect existed in Bombay Stock Market. The analysis of seasonality results pointed out there was no significant Friday Effect existed in Indian Stock Market. A gap exists between the studies as some are in favor that Indian stock market does not have seasonal anomalies, on the other hand, others are against seasonal anomalies behavior, so this gap helped in formulating the another objective which is to know whether seasonality is present in Indian stock market or not.

**Extent of Influence of US Stock Market on Indian Stock Market**

It is believed that US stock market has influence on Asian Emerging markets and any event or happening in the US stock market affects the Asian markets returns and hence portfolio diversification opportunities exist. Ahmad et al., (2005) revealed that no long-term relationship exist between Indian stock market with US and Japanese stock markets.
Majid et al. (2008) found that ASEAN (Association of South East Asian Nations) stock markets i.e. Malaysia, Thailand, Philippine, Indonesia and Singapore are mostly influenced by the US stock market and less by Japanese stock market.

Mariani et al. (2008) briefed that long-range power correlation is in existence between emerging economies i.e. India, China and Taiwan with developed country USA.

Aktan et al., (2009) found that BRICA economies and their relation with the US stock market was identified and found that US stock market has sound effect on all BRICA economies. An unexpected shock was immediately responded by all markets and recovered themselves within a time period of five to six days.


Gangadharan & Yoonus (2012) considered that there is feedback effect from US stock market of Indian stock market means any crisis in the US has its influence on Indian stock market but there is no feedback from Indian stock market to US stock market i.e Indian stock market has no impact on US stock market. On the other hand, there is literature supporting the view that USA stock market influence on other emerging stock markets is decreasing and no long term correlation of US stock market with other emerging stock markets is found.

Gupta & Guidi (2012) examined that there was less interdependence of Indian stock market with the US market and other developed Asian markets. It was also suggested that Indian stock market is not much affected by the international events. In comparison with developed Asian markets, Indian stock market volatility is more stable which give an opportunity to international investors for investment to improve returns.

Interdependence between Developed and Emerging Economies

The integration between developed and emerging economies is increasing with the passage of time. Chattopadhyay and Behera (2006) found that contrary to general belief, Indian stock market is not co-integrated with the developed market as yet. Of course, some short-term impact does exist, although it was found to be unidirectional for obvious reasons. That is to say, the developed stock markets, viz., USA, UK and Hong Kong stock markets Granger caused the India stock market but not vice versa. However, the study did not find any causality between the Japanese stock market and Indian stock market. It was derived from the study that although some positive steps have been taken up, which were responsible for the substantial improvement of the Indian stock market, these were perhaps not sufficient enough to become a matured one and hence not integrated with the developed stock markets so far.

Dhankar and Chakraborty (2007) investigated the presence of non-linear dependence in three major markets of South Asia, India, Sri Lanka and Pakistan. It was realized that merely identifying non-linear dependence was not enough. The application of the BDS test strongly rejects the null hypothesis of independent and identical distribution of the return series as well as the linearly filtered return series for all the markets under study.

Mukherjee (2007) captured to test the correlation between the various exchanges to prove that the Indian markets have become more integrated with its global counterparts and its reaction are in tandem with that are seen globally. It is validated that in the later time periods, the influence of other stock markets increases on BSE or NSE, but at a very low almost insignificant level. It can be safely said that the markets
do react to global cues and any happening in the global scenario be it macroeconomic or country specific affect the various markets.

Mukherjee and Mishra (2007) revealed that apart from exhibiting significant annual contemporaneous measures or same day inter-market relationship among India and most of the other foreign countries, the contemporaneous feedback statistics also reveals an increasing tendency in the degree of integration among the market over a period of time, leading to a greater co-movements and therefore higher market efficiency at the international scenario.

Kumar and Dhankar (2009) made efforts to examine the cross correlation in stock returns of South Asian stock markets, their regional integration and interdependence on global stock market. It is also examined what are the important aspects of investment strategy when investment decisions are made under risk and uncertainty. Its generalized models significantly explain the conditional volatility in all stock markets in question.

Raju (2009) discussed the issues of volatility and risk as these have become increasingly important in recent times to financial practitioners, market participants, regulators and researchers. It is mainly due to the changes in market microstructure in terms of introduction of new technology, new financial instruments like derivatives and increased integration of national markets with rest of the world. First, developed and emerging markets show distinct pattern in return and volatility behavior.

Mukherjee (2011) explored the relationship between volatility within not only the Indian equity market but also within other developed and emerging markets as well. It is found that Indian market returns also affect the returns in other markets such as Japan, the Republic of Korea, Singapore and Hong Kong, China. In addition, return volatility of the Indian market does not have an increasing or declining trend, but exhibits sudden sharp increases over the Period.

Ranpura et al. (2011) examined the short-run causal linkages among equity markets to better understand how shocks in one market are transmitted to other markets and also try to study co-movement of Indian stock market index with developed as well as developing countries’ stock market indices. It can be interpreted that SENSEX is interdependent on Developed economies stock markets except NIKKEI.

Tripathi and Sethi (2012) examined the short run and long run inter linkages of the Indian stock market with those of the advanced emerging markets viz, Brazil, Hungary, Taiwan, Mexico, Poland and south Africa. It was found that short run and long run inter linkages of the Indian stock market with these markets has increased over the study period. Unidirectional causality is also found. Some of these studies are against that there is interdependence of Indian stock market with international stock markets.

Siddiqui (2009) looked at that in recent years, globalization, economic assimilation and integration among countries and their financial markets have increased interdependency among major world stock markets. Results show that stock markets under study are integrated. The degree of correlation between the markets, but Japan, varies between moderate to very high. Furthermore, it provided that no stock market is playing a very dominant role in influencing other markets.

Paramati et al. (2012) aimed to investigate the long-run relationship between Australia and three developed (Hong Kong, Japan and Singapore) and four emerging (China, India, Malaysia and Russia) markets of Asia. While bivariate Johansen co- integration test provides results in supporting the long-run relationship between Australia-Hong Kong, Australia-India, and Australia-Singapore in the post-crisis period, the causal relationship from Australia to Asian markets disappears after the crisis. Results of VAR models demonstrated that there is no consistent lead-lag association between the observed markets.
Singh and Sharma (2012) examined the inter linkages of Brazil, Russia, India and China. The results revealed that there are visible effects of stock exchanges on each other. Russian, Indian and Brazilian stock markets affect each other and also effected by each other but Chinese stock market was not affected by these markets and these markets were affected by Chinese stock market.

Dasgupta (2014) found only one co-integration, i.e., long-run relationships and also short-run bidirectional Granger relationships in between the Indian and Brazilian stock markets. It was found that the Indian stock market has strong impact on Brazilian and Russian stock markets. The interdependencies (mainly on India and China) and dynamic linkages were also evident in the BRIC stock markets. Overall, it was found that BRIC stock markets are the most favorable destination for global investors in the coming future and among the BRIC the Indian stock market has the dominance. On the basis of above, it is seen that a gap is prevalent. This gave an origin to the objective of whether Indian stock market is interdependent on international stock markets or not so that this gap can be filled.

Financial services Unit-4

The term “financial services” in a broad sense mean “mobilizing and allocating saving”. Thus, it includes all activities involved in the transformation of saving into investment.

features of financial services.
It is a customer-intensive industry. Identification of need and wants of customer is the first step. It will help the financial service firms to design the financial strategy, which gives due respect to costs, liquidity and maturity consideration.

Demand and supply must be properly balanced.

Merchant banking.
The standard definition to the word „merchant bank” is given under:
“Merchant banking means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, underwriting or subscribing to the securities underwriter, manager, consultant, advisor or rendering corporate advisory in relating to such issue management”.

Merchant banking?
“An organization that underwrite corporate securities and advise clients on issue like corporate mergers, etc. involved in the ownership of commercial ventures”.

Public issue.
By using prospectus, companies raise fund from the public. This is a most common method of raising fund. Companies issue prospectus to issue shares. Shares issues through prospectus are in a fixed number.

Right issue?
Existing share holders have pre-emptive right in taking part in the right issue. In right issue, shares are offered to existing share holders according to the proportion of their share holding.

Private placement?
The direct sale of shares by a company to investors is called private placement. No prospects are issued in private placement. Private placement covers equity shares, preference shares and debentures.

Project Counselling”.
Project counselling includes preparation of project reports, deciding upon the financing pattern to finance to the cost of the project and apprising project report the financial institutions or banks.

Portfolio management.
Portfolio management refers to maintaining proper combination of securities in a manner that they give maximum return with minimum risk.

Issue management.
Management of issue involves marketing of corporate securities viz., equity shares, preference shares and debentures or bonds by offering them to public.

Advantage of public issue.
It provides liquidity for the existing share.
The reputation and visibility of the company increase. It commands better valuation for the company.

Forfeiting.
Forfeiting is a technique by which a forfeiter discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills.

Commercial Paper.
A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.
Treasury bill?
A treasury bill is also a money market instruments issued by the central government. It also issued at a
discount and redeemed at par. Recently, the government has come out with short term Treasury bill of
182-days bills and 364-days bills.

certificate of deposit?
The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation
on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable
instrument and hence it offers maximum liquidity.

deep discount bond?
There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large
discount to their nominal value. This bond could be gifted to any person.

Option bonds.
These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case
of cumulative bonds, interest is accumulated and is payable only on maturity.

Equity with 100% safety net.
Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the
issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at
any, irrespective of the market price.

Convertible bonds.
A convertible bond is one which can be converted into equity shares at per-determined timing either fully
or partially. They are compulsory convertible bonds which provide for conversion within 18 months of
their issue. There are optionally convertible bonds which provide for conversion within 36 months.

Easy exit bonds.
As the name indicates, this bond enables the small investors to encase the bond at any time after 18 months
of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option
any time after 5 years.

22. Carrot and stick bonds.
Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call
the bond at a specified premium if the common stock is trading at a specified percentage above the strike
price.

23. Global depository Receipt (GDR).
Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the
U.S.A. or both. It represents a certain number of underlying equity shares.

24. Blue chip share.
Share of well known and established companies are called blue chip share. They must show consistent
growth over the years. These shares have bright future prospects and they are expected to contribute
sustained growth in the future also.

25. Defensive shares.
These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors' money.

Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.

27. Cyclical Vs Non-cyclical shares?
Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc. If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.

28. Turn around Shares?
Turn around shares is those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.

29. Active Shares?
Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold at least three times a week. Investors can buy or sell these shares quite easily in the market.

30. Alpha Shares?
Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

31. Sweat shares?
Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

32. Financial Engineering?
Thus, the growing need for innovation has assumed immense importance in recent times. This process is being referred to as financial engineering. Financial engineering is the lifeblood of any financial ability “Financial engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance”

33. Loan Syndication?
This is more or less similar to „consortium financing”. It refers to a loan arranged by a bank called leader manager for a borrower who is usually a large corporate customer or a Government Department. The other banks who are willing to lend can participate in loan by contributing an amount suitable to their own lending polices. Since a single bank can not provide such a huge sum as loan, a number of banks joint together and form a syndicate.

34. Leasing?
A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called “rental charges”. The lessee can not acquire any ownership to the asset, but he can use it and have full control over it. He is expected to pay for all maintenance charges and repairing and operating costs.

35. Venture Capital?
A venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project. It is in contrast to the conventional “security based financing”. Much thrust is given to new ideas or technological innovations. Finance is being provided not only for „start-up capital” by the financial intermediary.

36. Securitization?
Securitization is a technique where by a financial company converts its ill-liquid, non-negotiable and high value financial assets into securities of small value which are made tradable and transferable. A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc.

37. Reverse Mortgage?
In a Reverse Mortgage the owner of a house property surrenders the title of his property to a lender and raises money, a lender does not pay the entire amount. On the other hand, he pays out a regular sum each month for the agreed time. The owner, normally a senior citizen, can use the property and stay with his spouse for the rest of their lives. Thus, the owner can ensure a regular cash flow in times of need and enjoy the benefit of using the property. Usually, after the death of the owner, the spouse can continue to use the property. In case, both die during the period of the RM scheme the lender will sell the property, take his share and distribute the rest among the heirs. It is called reverse mortgage because the payment steam is “reversed”.

A derivative security is a security whose value depends upon the value of other basic variables backing the security. In most cases, these variables are nothing but the prices of traded securities. A derivative security is basically used as a risk management tool and it is to cover the risks due to price fluctuations by the investments manager. Naturally the value of a derivative security depends upon the value of the backing security.

39. Forward contracts.
A forward transaction is one where the delivery of a foreign currently takes place at a specified future date for a specified price. It may have a fixed maturity for, e.g. 31st May or a flexible maturity for e.g. 1st to 31st May. Forward contracts are permitted only for genuine business transactions.

40. Swaps?
A swap refers to a transaction where in a financial intermediary buys and sells a specified foreign currency simultaneously for different maturity dates-say, for instance, purchase of spot and sale of forward or vice versa with different maturities. Thus, swaps would result in simultaneous buying and selling of the same foreign currency of the same value for different maturities to eliminate exposure risk.

41. Letter of credit (LOC).
It is an innovative funding mechanism for the import of goods and service on deferred payment terms. LOC is institution/bank of one country with another institution/bank/agent to support the export of goods and services so as to enable the importers to import no differed payment terms. This may be backed by a
guarantee furnished by the institution/bank in the importing country. The greatest advantage is that it saves a lot of time and money on natural”s verifications of bonafides, source of finance etc. It serves as a source of forex.

5. characteristics of financial services.
   - It is a customer-intensive industry. Identification of need and wants of customer is the first step. It will help the financial service firms to design the financial strategy, which gives due respect to costs, liquidity and maturity consideration.
   - Financial services are intangible in nature. The institution providing the services should have a good image and confidence of the client. The have to focus on quality and innovativeness of their services, this will build credibility and gain the trust of clients.
   - Production and supply of financial services must be performed simultaneously. This demands a clear-cut organization and their clients.
   - Demand and supply must be properly balanced. This is because of the perishable nature of financial services.
   - Marking of financial people intensive. It is subject to variability of performance and quality of service. The personnel in financial services firms need to be selected, based on their suitability.
   - Financial services firm should always be proactive in visualizing in advance what the market wants, or reactive to the needs and wants of customers. They must always be changing to the tune of the market.

6. classifications of financial services industry?
The financial intermediaries in India can be traditionally classified into two:
   - Capital market intermediaries and
   - Money market intermediaries.
The capital market intermediaries consist of term lending institutions and investing institutions which mainly provide long term funds. On the other hand, money market consists of commercial banks, co-operative banks and other agencies which supply only short term funds. Hence, the term “financial services industry” includes all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers.

7. scope of merchant banking in India.
   - Growth of new issue market
   The growth of new issue market is unprecedented since 1990-91. The amount of annual average of capital issue by non-government public companies was only about 90crs in 70s, the same rose to over Rs.1000crs in the 80”s and further to Rs.12700crs in the first 4 years of 1990”s. The figure could be well beyond Rs.40000crs by the end of 1994-95.
   - Entry of foreign investors
   An outstanding development in the history of Indian capital market was its opening up in 1992 by allowing foreign institution investors to invest in primary and secondary market and also permitting Indian companies to directly tap foreign capital through euro issue. Within two years to march 1994, the total inflow of foreign capital through these routes reached to about 5bills.

   - Changing policy of financial institutions
   With the changing emphasis in the lending policies of financial institutions from security ordination to project orientation, corporate enterprises would require the expert services of merchant bankers for project appraisal, financial management.
Development of debt market
The concept of debt market has set to work through national stock exchange and the over the counter exchange of India. Experts feel that of the estimated capital issue of Rs.40000crs in 1994-95 a good portion may be raised through debt instruments. The development of debt market will offer tremendous opportunity to merchant bankers.

Innovations in the instruments
The Indian capital market has witnessed innovations in the introduction of financial instrument such as non-capital debentures with detachable warrants, cumulative convertible preference shares, zero coupon premium notes, floating rate bonds, auction rate debentures etc.

Corporate restructuring
As a result of liberalization and globalization the competition in the corporate sector is becoming intense. To survive in the competition; companies are reviewing their strategies, structure and function.

8. The guidelines for merchant bankers issued by Securities and Exchange Board of India (SEBI).

9. Merchant banking has been statutorily brought within the framework of the securities and exchange board of India under SEBI [merchant bankers] regulation, 1992.

9. The criteria for authorization include:
   - Professional qualification in financier, law or business management. Infrastructure like adequate office space, equipment and manpower.
   - Employment of two persons who have the experience to conduct business of merchant bankers.
   - Capital adequacy.
   - Past track of record, experience, general reputation and fairness in all transactions.

10. Securities and Exchange Board of India (SEBI) issued further guidelines classifying the merchant banker into four categories based on the nature and range of activities and their responsibilities to SEBI investors and issuers of securities.

The second category consists of those authorized to act in the capacity of co-manager/advisor, consultant, and underwriter to an issue or portfolio manager.

The third category consists of those authorized to act as underwriter, advisor or consultant to an issue.

The fourth category consists of merchant bankers who act as advisor.

The above classification was valid up to December 1997 only.

11. An initial authorization fee, an annual fee and renewal fee may be collected by Securities and Exchange Board of India (SEBI)

12. All issues must be managed at least by one authorized banker, function as the sole manager or the lead manager. Ordinarily not more than two merchant bankers should be association as lead managers.

13. Each merchant banker is required to furnish to the Securities and Exchange Board of India (SEBI) half yearly unaudited financial result when required by it with a view to monitor the capital adequacy of the merchant banker.

14. The lead merchant banker holing a certificate under category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakhs whichever is less.

15. The above guidelines will be administered by Securities and Exchange Board of India (SEBI) and it will supervise the activities of merchant bankers.

16. Securities and Exchange Board of India (SEBI) has been vested with power to suspend or cancel the authorization in case of violation of the guidelines.

The notification procedure relating to action to be initiated against merchant banks in case of default has been detailed out. The regulations empower Securities and Exchange Board of India (SEBI) to take action against defaulting banker such as suspension/cancellation of registration.

13. the detail the merchant banking in India.
In India prior to the enactment of Indian companies act, 1956, managing agents acted as issue hours for securities, evaluated project reports, planned capital structure and to some extent provided venture capital for new firms. Few share broking firms also functioned as merchant bankers.

The need for specialized merchant banking service was felt in India with the rapid growth in the number and size of the issues made in the primary market. The merchant services were started by foreign banks, namely the national grind lays bank in 1967 and city bank in 1970. The banking commission in its report in 1972 recommended the setting up of merchant banking institutions, this market the beginning of specialized merchant banking in India.

The begin with, merchant banking services were offered along with other traditional banking services in the mid-eighties, the Banking Regulations Act was amended permitting commercial banks to offer a wide range of financial services through the subsidiary rule. The state bank of India was the first Indian banks to set-up merchant its merchant banking division in 1972. Later bank ICICI set up its merchant banking division followed by bank of India, bank of Baroda, Punjab national bank and UCO Bank. The merchant banking gained prominence during 1983-84 due to new issue boom.

14. the issue management.
Issue management refers to management of securities offering of client to the general public and existing shareholders on right basis. Issue managers are known as merchant banker or lead managers. Merchant banker has many more tasks to be carried out. Of which, issue management is the most important and sizable function within. The terms „merchant banking” and „issue management” are generally used interchangeably.

Public issue and right issue of more than Rs.50lakhs is required to be managed by a category merchant banker under Securities and Exchange Board of India (SEBI) guidelines. Industry of present is badly in need of funds. Issue management has tremendous scope and potential in supplying such funds to the industry.

Merchant bankers provide their skills and experience to clients in managing the capital issues. It essentially aims at converting the saving of household into viable investment of clients. The investment covers investment on new projects, expansion, modernization and diversification of existing units and augmenting the long-term sources for working capital purpose. Issues are of three types, a) public issue b) Right issue, C) Private Placement.

15. the functions of a Merchant Banker.
The following comprise the main functions of Merchant Banker: Management of debt and equity offerings
This forms the main function of the Merchant Banker. He assists the companies the raising from the market. The main areas of work in this regard include: instrument designing, pricing the issue, registration of the offer document, underwriting support, and marketing of the issue, allotment and refund, listing on stock exchanges.

Promotional activities
A merchant bank functions as a promoter of industrial enterprises in India. He helps the entrepreneur in conceiving an idea, identification of projects, preparing feasibility reports, obtaining Government approvals, and incentives etc.

Placement and distributions
The merchant banker helps in distributing various securities like equity shares, debt instruments, mutual fund products, fixed deposits, insurance products, commercial papers to name a few. The distribution network of the merchant banker can be classified as instructional and retail in nature.

Project advisory services
Merchant bankers help their clients in various stages of the project undertaken by the clients. They assist them in conceptualizing the project idea in the initial stage. Once the idea is formed, they conduct feasibility studies to examine the viability of the proposed project.

Loan syndication
Merchant bankers arrange to tie up loans for their clients. This takes place in a series of steps. First, they analyze the pattern of the client’s cash flows, based on which the terms of borrowing can be defined. Then the merchant banker prepares a detailed loan memorandum, which is circulated to various banks and financial institutions and they are invited to participate in the syndicate. The banks then negotiate the terms of lending based on which the final allocation is done.

Providing venture capital and mezzanine financing
Merchant bankers help companies in obtaining venture capital financing for financing their new and innovative strategies.

Leasing Finance
Merchant Bankers provide leasing finance facilities to their clients.

Bought out deals
It involves a deal where the entire securities are bought in lots. It is done with an intention of offloading them later in the market. The deal is done in two stages—first, the client issues shares to the retail investors at a higher price. The merchant banker is required to appraise the project, invest in the client and offer the shares to the public for subscription. The client, on the other hand, need not wait for months together to use the issue proceeds and gets an attractive price for his shares. In addition, it allows companies to raise capital without facing the uncertainties of the market place.

Non-resident Investment
The merchant bankers provide investment advisory services in terms of identification of investment opportunities, selection of securities, portfolio management, etc. to attract NRI investment in the primary and secondary markets.

Advisory services relating to mergers and acquisitions
Mergers and takeovers are popular in these days. There may be several reasons for mergers and acquisitions. They vary from elimination of competition, expansion of capital through tie-ups and to go global.

Portfolio management
Merchant bankers offer services not only to the clients issuing the securities but also to the investors. They advise their clients, mostly institutional investors, regarding investment decisions. Merchant bankers even undertake the function of purchase and sale of securities for their clients to provide them:
(a) To identify the potential targets of takeovers,
(b) To appraise the merger/takeover proposals with respect to financial viability and technical feasibility,
(c) To negotiate with interested parties,
(d) To determine the purchase consideration and the appropriate exchange offer,
(e) To assist in matters related to procedural and legal aspects, and
(f) To obtaining necessary approvals.

16. Financial services cover a wide range of activities. They can be broadly classified into two namely:

(iii) Traditional activities
(iv) Modern activities
Traditional activities

Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads viz;

- Fund based activities and
- Non-fund based activities

The traditional services which come under fund based activities are the following:

(i) Underwriting of or investment in shares, debentures, bonds etc, of new issues (primary market activities)
(ii) Dealing in secondary market activities.
(iii) Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc.
(iv) Involving in equipment leasing, hire purchase, venture capital, Seed capital etc.
(v) Dealing in foreign exchange market activities.

Non-fund based activities

Financial intermediaries provide services on the basis of non-fund activities also. This can also be called “fee based” activity. They expect more from financial service companies. Hence, a wide variety of service, are being provided under this head they including the following:

(iv) Making arrangements for the placements of capital and debt instruments with investments institutions.
(v) Arrangements of fund from financial institutions for the clients” project cost or his working capital requirements.
(vi) Assisting in the process of getting all government and other clearances.

Modern activities

Besides the above traditional services, the financial intermediaries render innumerable service in recent times. Most of them are in the nature of non-fund based activity. In view of the importance, these activities have been discussed in brief under the head „New financial products and services”. However, some of the modern services provided by them are given in brief hereunder:

(vi) Rendering project advisory services right from the preparation of the project report till the raising of funds for starting the project with necessary government approval.
(vii) Planning for mergers and acquisitions and assisting for their smooth carry out.
(viii) Guiding corporate customers in capital restructuring.
(ix) Acting as trustees to the debenture-holders.
(x) Recommending suitable changes in the management structure and management style with a view to achieving better result.

17. Write any ten innovative financial instruments.
- Commercial paper
A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.

- Treasury bill
A treasury bill is also a money market instruments issued by the central government. It also issued at a discount and redeemed at par. Recently, the government has come out with short term Treasury bill of 182-days bills and 364-days bills.
- Certificate of deposit
The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity.
Deep discount bonds
There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large discount to their nominal value. This bond could be gifted to any person.

Option Bond

These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity.

Equity with 100% safety net
Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at any, irrespective of the market price.

Convertible bonds
A convertible bond is one which can be converted into equity shares at per-determined timing either fully or partially. They are compulsory convertible bonds which provide for conversion within 18 months of their issue. There are optionally convertible bonds which provide for conversion within 36 months.

Easy exit bond
As the name indicates, this bond enables the small investors to encash the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.

Carrot and stick bonds
Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price.

Global depository Receipt (GDR)
Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. or both. It represents a certain number of underlying equity shares.

Classification of equity shares

Blue chip share
Share of well known and established companies are called blue chip share. They must show consistent growth over the years. These shares have bright future prospects and they are expected to contribute sustained growth in the future also.

Defensive shares
These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors’ money.

Growth shares
Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.

Cyclical Vs Non-cyclical shares
Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc.
If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.

Turn around Shares
Turn around shares is those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.

Active Shares
Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold at least three times a week. Investors can buy or sell these shares quite easily in the market.

Alpha Shares
Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

Sweat Shares
Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

19. Write about challenges facing the financial services sector.

However, the financial service sector has to face many challenges in its attempt to fulfill the ever growing financial demands of the economy. Some of the important challenges are briefly reported hereunder:

Lack of qualified personnel
The financial services sector is fully geared to the task of financial creativity. However, this sector has to face many challenges. In fact, the dearth of qualified and trained personnel is an important impediment in its growth.

Lack of investor awareness
The introduction of new financial products and instruments will be of no use unless the investor is aware of the advantages and uses of the new and innovative products and instruments.

Lack of transparency
The whole financial system is undergoing a phenomenal change in accordance with the requirements of the national and global environments. It is high time that this sector gave up their orthodox attitude of keeping accounts in a highly secret manner. Hence, this sector should opt for better levels of transparency.

Lack of specialization
In the scene, each financial intermediary seems to deal in different financial service lines without specializing in one or two areas. In other words, each intermediary is acting as financial supermarket delivering so many financial products and dealing in different varieties of instruments.

Lack of recent data
Most of the intermediaries do not spend more on research. It is very vital that one should build up proper data base on the basis of which one could embark upon financial creativity. Moreover a proper data base would keep oneself abreast of the recent developments in other parts of the whole world and above all, it would enable the fund managers to take sound financial decisions.

20. Critically analyses the present position of the financial service sector in India.

Conservation to dynamism
At present, the financial system in India is in a process of rapid transformation, particularly after the introduction of reforms in the financial sector. The main objective of the financial sector reforms is to promote an efficient, competitive and diversified financial system in the country. This is essential to rise the allocate efficiency of available savings, increase the return on investment and thus to promote the accelerated growth of the economy as whole.

Emergence of Primary Equity Market
Now, we are also witnessing the emergence of many private sector financial services. The capital markets which were very sluggish have become a popular source of raising finance. The number of stock
exchanges in the country has gone up from 9 in 1980 to 22 in 1994. The aggregate funds raised by the industries in the primary markets have gone from Rs. 5976 crore in 1991-92 to Rs. 32382 crore in 2006-07.

- **Concept of Credit Rating**
  There is every possibility of introducing Equity Grading. Hitherto, the investment decisions of the investors have been based on factors like name recognition of the company, operations of the Group, market sentiments, reputation of the promoters etc. Now, grading from an independent agency would help the investor in his portfolio management and thus, equity grading is going to play a significant role in investment decision-making.

- **Process of Globalisation**
  Again, the process of globalization has paved the way for the entry of innovative and sophisticated financial products into our country. Since the government is very keen in removing all obstacles that stand in the way of inflow of foreign capital, the potentiabilities for the introduction of innovative international financial products in India are very great.

- **Process of Liberalization**
  Realizing all these factors, the government of India has initiated many steps to reform the financial services industry. The government has already switched over to free pricing issues by the controller of capital issues. The interest rates have been deregulated. The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized.

14. **Mutual Funds.**

According to Weston J.fed and Brigham, Euqene, F., units trust are “corporations which accept dollars from savers and then use these dollars to buy stock, long term bonds, short term debt instruments issued by business or government units; these corporations pool funds and thus reduce risk y diversification.”

15. **Mutual fund?**

A mutual fund is a trust that pools the saving of number of investors who share a common financial goal. Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors.

16. **different types of Mutual Funds.**

- **Operational classification**
  - Open ended mutual fund
  - Close ended mutual fund
  - Interval funds

- **Portfolio classification**
  - Growth oriented funds
  - Income oriented funds
  - Balanced funds
  - Bond funds
  - Stock funds
  - Index funds
Geographical funds classifications

Structural classification

17. the regulation of SEBI on the Mutual funds.

The mutual fund company must be a registered company

Capital structure must be according to the regulations stipulated by SEBI

Every mutual fund company must give their Net Asset value periodically preferably weekly in the leading newspapers of the country.

18. Net Asset Value?

The Net Asset value of the fund is the cumulative market value of the assets of the fund net of its liabilities. In other words, the fund is dissolved or liquidated by selling off all the asset in the fund, this is the amount that the shareholders would collectively own.

19. Balanced fund?

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

20. Gilt fund?

These funds invest exclusively in government securities have no default risk NAVS of these schemes also fluctuate due to change in interest rates and others economic factors as is the case with income of debt oriented schemes.

21. term Money Market Mutual fund?

These funds are generally invested in money market instruments such as treasury bills certificate of deposit. Commercial paper, bills discounting, etc. these are regulated on the basis of specified guidelines laid down by the reserve Bank of India.

22. specialized fund?

A large number of specialized funds are existence abroad. They offer special schemes so as to meet the specific needs of specific categories of people like pensioners. Widows etc. There are funds for investments in securities of specified areas.

23. UTI?
UTI was set up in 1964 by an act of parliament. It commenced its operation from July 1964 with a view to encouraging saving and investment and participation in the income, profit and gain accruing to corporation from the acquisition, holding management and disposal of securities.

24. Index funds?

Index funds invest only in those shares which are included in the market indices and in exactly the same proportion. Whenever the market index goes up the value of such index funds also goes up. Conversely when the market index comes down the value of such index funds also goes down.

25. features of Closed – ended funds.

The period and/or the target amount of the fund are definite and fixed beforehand.

Once the period is over and/or the target is reached, the door is closed for the investors they cannot purchase any more units.

26. features of Open – ended funds.

These units are not publicity traded but, the fund is ready to repurchase them and resell them at any time. The main objectives of this fund is income generation the investors get dividend relight or bonuses as rewards for their investment.

3. the types of Mutual funds?

Mutual funds can be classified under four different categories

1. Operational classification
2. Portfolio classification
3. Geographical classification
4. Structural classification

Operational classification

Mutual funds are broadly categorized into three types, namely

d) open ended mutual funds,
e) close ended mutual funds,
f) Interval funds
Open ended Mutual funds:

SEBI regulations defines open ended schemes “a scheme of a mutual funds which is offering units for sales or has outstanding any redeemable units and which does not specify any duration for redemption or repurchase or units” open ended mutual funds all open throughout the year for investment and redemption the units are bought and sold directly by the fund.

Closed ended Mutual funds:

Closed end mutual funds have a definite period after which their shares / units are redeemed. The units are offered to the investors through the public issue and after the date of closure, the entry to the investor is closed. Closed end mutual fund schemes are generally trades among the investors in the secondary. Market since they are to be quoted stock exchange.

Interval funds:

Interval funds combine the features of open ended and closed ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

Portfolio classification:

Mutual funds differ with reference to their instruments therefore, different mutual funds are designed to meet the needs of the investors this section discusses the types of mutual funds classified on the basis of their portfolio

Income oriented funds:

The main objectives of this fund is to provide regular income to the investors in the form of dividends the dividends may be cumulative or non-cumulative on a quarterly, half yearly, or yearly basis.

Balanced funds:

These funds aim at distributing both income and capital appreciation to the investors. Technically the corpus of this scheme is invested quality in high growth equity shares and fixed income earning debentures.

Geographical classification:

On the basis of geographical limits, mutual funds schemes can be classified as domestic mutual funds and off share mutual funds.

Domestic mutual funds:

Domestic mutual fund schemes mobilize the savings of the citizens of the county. However the NRIs and foreign investors can invest in these schemes. All the schemes in vogue in the country are the domestic mutual fund schemes.

Off share Mutual funds:

These funds enable the NRIs and international investors to participate in Indian capital market further these funds are governed by the rules and procedures laid down for the purpose of approving and monitoring their performance by the department of economic affairs, ministry of finance and the direction of RBI.

Structural classification:
Structure, mutual funds can be divided in two categories namely a capital market mutual funds and money market mutual fund. Mutual funds generally invest the pooled resources in capital market instruments whereas money market mutual funds invest in money market instrument.

4. the advantages of Mutual fund?

Advantages of mutual funds

Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors. The dividend fluctuates with the income on mutual funds" investments mutual funds are advantages to individual investors in relation to their direct involvement in investment portfolio activity covering the following aspects.

7. Reduced Risk:

Mutual funds provide investors access to reduced investment risk resulting from diversification, economics of scale in transaction cost and professional finance management.

8. Diversified investment

Small investors participate in larger basket of securities and share the benefits of efficiently managed portfolio by expects and are freed of keeping any records of share certificates etc.

9. Stress free investment

Investors get freedom from emotional stress involved in buying or selling securities mutual funds relieve them from such stress as it is managed by professional experts who act scientifically with right timing in buying and selling for their clients.

10. Revolving type of investment

Automatic reinvestment of dividends and capital gains provides relief to investors so that invested funds generates higher return to them the members of mutual funds.

11. Wide investment opportunities

A ailment of wider investment opportunities that create an increased level of liquidity for the funds holders become possible because of package of more liquid securities in the portfolio of mutual funds.

12. Selection and timings of investment

Expertise in stock selection and timing is made available to investors so that invested fund generates higher returns to them.

7. Review the growth of Mutual funds in India?

The fundamentals are strong and macro-economic indicators are strong one would expect most sectors to perform well and are expecting a bull run in the market is expected to gain around 20-25% and mutual funds will be able to provide those kind of returns enabling one to take advantage of the markets.

The economy slowly picked up after Septembers issues. In year 2002 however poor monsoon affected the stock markets. Disinvestments stores, securitization bill, security interest bill, entrance of it players in It element and other positive news boosted the stock market and that helped the equity funds to post the good returns.
Fixed income markets witnessed a steep decline in interest rate of around 300 basis points in 2001.

8. the various schemes of UTI for different categories of investors?

Specific investment schemes of UTI as a mutual fund that are beneficial to mutual fund holders are given below.
1. Income Plan
2. Growth Plan
3. Reinvestment Plan
4. Systematic Plan
5. Systematic withdrawal plan
6. Insurance plan

Income plan

The mutual funds distribute a substantial part of the surplus to investors in the dividends.

Growth plan

An investors realize only capital appreciation on the investment and normally does not get any income in the form of income distribution.

Investment plan

Here, the accrued income is reinvested in the purchase of additional units.

Systematic investment plan

The investor is given the option of managing investment on a periodical basis and thus inculcating a regular saving habit. He may issue pre-determined number of postdated cheques in favour of the fund.

Systematic withdrawal plan

This is quite opposite to the systematic investment plan. In systematic withdrawal plan, investor is given the open of withdrawing his investment among at a pre-determined date and among from the fund.

Insurance plan

Here, the investors are given an insurance cover against life or personal accident example L unit linked insurance plan UTI.

9. To want expend commercial Banks in India are better fitted to take up the Mutual funds

Commercial banks and mutual funds:

With a view to providing wider choice to small investors, the government of India has permitted the banks to enter into the field of mutual funds due to the following reason.

Banks are not able to provide better field to the investing public with their saving and fixed deposit interest rates whereas many financial intermediates with innovative market instrument offering very attractive returns, have earn the financial market.

The gross domestic savings has risen from 10% in fifties to 20% in righties, thanks to the massive branch expansion programmed of banks and their growing deposit mobilization.
Indian investors, particularly small and medium ones, are not very keen in investing any substantial amount directly in capital market instrument. They may also hesitate to invest in an indirect way through private financial intermediaries. Earlier banks were not permitted to tap the capital market for funds or to invest their funds in the market. Now a green signal has been given to them to enter into this market and reap the maximum benefits. Banks can provide a wider range of products services in mutual fund by introducing innovative schemes and extend their professionalism to the mutual fund industry. Banks, as merchant banks have wide experience in the capital market and hence managing mutual fund may not be a big problem for them. The entry of banks would provide much needed competition in the mutual fund industry which has been with to monopolize by the UTI. The competition will improve customer service and wider customer choice also.

10. the features of open ended funds?

There is complete flexibility with regard to one”s investment or disinvestment. In other words, there is free entry and exist of investors in an open ended fund. These units are not publicly traded but the fund is ready to repurchase them and resell them at any time. The investor is offered instant liquidity in the sense that the units can be sold on any working day. In fact, the fund operates just like a bank account where in 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 onuses as rewards for their investment. Since the units are not listed on the stock market, their prices are linked to the net asset value of units. The NAV is determined by the fund and it varies from to time. Generally, the listed prices are very close to their Net Asset value. The fund fixes a different price for their purchases and sales. 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 the scheme.

13. leasing

Dictionary of business management „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 a rent.

14. leverage lease and non-leveraged leases?

The value of the assets leased may be of a huge amount which may not be possible for the lessor to financial so the lessor involves one more financial who will have charge over the leased asset.

15. financial lease
Financial lease is a contract involving payment over a longer period. It is long term lease and the lessee will be paying much more than the cost of property or equipment to the lessor in the form of lease charges it is irrecoverable. In this type of leasing the lessee has to bear all costs and the lessor does not render any services.

16. operating lease?

The lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice. In this type of leasing (a) lessor bears all expenses (b) lessor will not be able to the realise the full cost of the asset (c) specialized services are provided by the lessor.

17. cross border lease?

Lease across national frontiers are called cross border lease shipping, air service etc., will come under this category.

18. the advantages of leasing?

1. Permit alternative use of funds
2. Faster and cheaper credit
3. Flexibility
4. Facilitates additional borrowings
5. Protection against obsolescence
6. No restrictive covenants
7. Hundred Percent tenanting
8. Boom to small firm.

19. disadvantages of leasing?

1. Certain tax benefits incentives such as subsidy may not be available on leased equipment.
2. The cost of financing is generally higher than that of debt financing.

20. the different types of leasing

1. Financial lease.
2. Operating lease.
3. Leveraged and non leveraged lease
4. Conveyance type lease
5. Sale and lease pack
6. Full and non pay – out lease.
7. Specialized service lease.
9. Sales aid lease.
10. Cross border lease.
11. Tax oriented lease.
12. Import leasing.
13. International lease.

21. flexibility?

Leasing arrangement may be tailored to the lessee”s needs more easily that 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 below.

22. contents of lease agreement
1. Description of the lessor, the lessee, and the equipment.
2. Amount, time, and place of lease rental payments.
3. Time and place of equipment delivery.

23. the problems of leasing
1. Unhealthy competition
2. Lack of qualified personnel
3. Tax considerations
4. Stamp duty
5. Delayed payment and bad debts.
24. lease finance?

Here a third party comes into the contract by financing the lessor for purchasing the asset or equipment which is meant for leasing. The financial may have a control over machinery by a separate contract with lessor.

7. different types of leasing?

Definition of leasing

“Lease is a contract where by the owner of an asset grants to another party the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent”.

Types of leasing

1. Financial leasing.
2. Operating leasing.
3. Leveraged and non – leveraged leases.
4. Conveyance type lease
5. Sale and lease pack
6. Full and non pay – out lease.
7. Specialized service lease.
9. Sales aid lease.
10. Cross border lease.
11. Tax oriented lease.
12. Import leasing.
13. International lease.

Financial lease:

It is a contract involving payment over a longer period it is a long – term. lease and the lessee will be payment much more than the cost of the property or equipment to the lessor in the form of lease charges.

Operating lease:

The lessee used the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks.
1. Lessor bears all expenses
2. Lessor will not be able to realize the full cost of the asset.

3. Specialized service is provided by the lessor.

Leveraged and non–leveraged leases

The value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So the involves one more financier who will have charge over the leased asset.

Conveyance type lease:

Here the lease will be for a long- period with a clear intention of conveying the ownership of title on the lessee.

Sale and lease pack:

Here a company owning the asset sells it to the lessor. The lessor pays immediately for the assets but leases the asset to the seller. This arrangement is done so that the selling company obtains finance for running the business along with the asset.

Full and non pay- out lease:

A full pay- out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay– out lease. The lessor leases out the same asset over and over again.

Specialized service lease:

The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods automobiles, air conditioners, etc.

Net and non- net lease:

In non-net lease, the lease in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

Sales aid lease:

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

Cross border lease:

Lease across national frontiers are called cross border lease. Shipping, air service, etc. will come under this category.

Tax oriented lease:

Where the lease is not a loan on security but qualities as a lease, it will come under this category.

Import leasing:

Here the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

International lease:
Here the parties to the lease transactions may belong to different countries which are almost similar to cross border lease.

8. the advantages of leasing?
   - Most of the leasing agreements are modified according to the requirement of the lessee.
   - The lessee is able to derive the benefits out of the asset without owning it.
   - The lessee is able to save considerable amount of capital which otherwise will be locked up the asset.
   - Leasing is the cheapest and fastest mode of acquiring an asset, from the creditor"s point of view; it is the safest method of finance as they have a good security in the form of asset.
   - Capital projects can be financed by leasing method and hence most of the financial institutions have started entering leasing business.
   - Because of leasing, the lessee is able to have better debt- equity ratio. He can also go for additional borrowings in case of business requirement.
   - It is only by leasing method, 100percent finance is available for buying equipment
   - Equipment which is likely to be obsolete very soon can be acquired under operating leasing.
   - Small scale industries will be benefited by leasing as they can go for modernization of production.
   - Technocrats will get more benefits by leasing as the promoters will find it difficult to contribute margin money.
   - The lease charge forms a part of profit & loss a/c and does not appear in the balance sheet. Hence, the return on investment for the investment capital.
   - Tax benefits are available to both lessor and lessee in leasing.
   - Leasing is the best method available to monopoly companies to escape MRTP commission.

9. Different between financial lease and operating lease.

Financial lease

Operating lease

8. The asset is procured purely for the benefit of the lessee and the lessor has lesser benefit compared to the lessee.

9. The risk and benefit of the asset is passed on to the lessee and only owner ship is with the lessor.

10. It the asset becomes obsolete, it is the risk of the lessee.

11. The lessor is more concerned with the rent or lease amount as there is repayment of the principal amount along with the interest.
12. The lease is non revocable or irrevocable by either party.

13. Lease period goes along side with life of the asset and there is primary and secondary period.

14. The lessor is only financier and does not...
7. The asset is meant for a number of lessees.

8. The lessee is in possession of the asset only for a particular time and hence risk is more borne by lessor.

9. Since the lease time is short. The risk of obsolescence is with the lessor.

10. The lessor is not only concerned with the rentals. But also the asset as it has to be given to number of lessees.

11. The lease is revocable especially by the lessee.

12. The lease period is small and the lessor leases the asset number of time with different users.

bear the cost of operation.

8. It is mostly a single lease by which the lease repays the cost of the asset with interest
9. The lessor bears cost of repair, maintenance etc.

10. The lease is non pay-out and lessor can recover the value of asset only by repeated leasing to different lessees.

10. disadvantages of leasing?

☐ Lease is not suitable mode of project finance. This is because rental are repayable soon after entering into lease agreement which in new projects cash generations may start only after a long gestation period.
Certain tax benefits/incentives such as subsidy may not be available on leased equipment.

The value of real assets such as land and building may increase during lease period. In such a case the lessee loses the advantages of a potential capital gain.

The cost of financing is generally higher than of debt financing.

A manufacturer who wants to discontinue a particular line of business will 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 his well.

If the lessee is not able to pay rentals regularly, the lessor would suffer a loss particularly when the asset is a sophisticated one and less liquid.

In case of lease agreement, it is lessee who has purchased the asset from the supplier and not the lessor. Hence, the lessee by himself is not entitled to any protection in case the supplier commits breach of warranties in respect of the leased assets.

In the absence of exclusive laws dealing with the lease transaction several problems crop up between lessor and lessee resulting in unnecessary complications and avoidable tension.

11. Structure of leasing industry in India

The present structure of leasing industry in India consists of (i) private sector leasing and (iii) Public sector leasing.

The private sector leasing consists of:

- Pure leasing companies.
- Hire purchase and finance companies, and
- Subsidiaries of manufacturing group companies.

The public sector leasing organizations are divided into

- Leasing divisions of financial institutions.
- Subsidiaries of public sector banks. And
- Other public sector leasing organizations.

Pure leasing companies

These companies operate independently without any like 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, full under this category.

Hire purchase and finance companies:

The companies started prior to 1980 to do hire purchase and finance business especially for vehicles added to their activities during 1980 some of them do leasing as major activity and some other do leasing on a small scale as a tax planning device sundaram finance limited and motor and general finance limited belong the company.

Subsidiaries of manufacturing group companies

There companies consist of two categories.
(c) Vendor leasing

(d) In house leasing

(c) Vendor leasing:

These types of companies are formed to boost and promote the such of its parent companies products through offering leasing facilities.

(d) In house leasing:

In house leasing or capture leasing companies are set up to meet the fund requirement or to avoid the income tax liabilities of the group companies.

Public sector leasing:

(i) Financial institutions

The financial institutions such as IFCI, ICICI, IRBI and NSIC have setup their leasing business. The shipping credit and investment company of India offers leasing facilities in foreign currencies for ships, deep, seas fishing vehicles and related equipment to its clients.

Subsidiaries of banks:

The commercial banks in India can, under section 19(1) of the banking Regulation Act 1949, setup subsidiaries for undertaking leasing activities. The SBI was the first bank to start a subsidiary for leasing business in 1986.

Other public sector organizations:

A few public sector manufacturing companies such as bharat electronics limited, Hindustan packaging company limited, Electronic corporation their equipment through leasing.

12. What are the problems of leasing in India?

Leasing has great potential in India. However, leasing in India faces serious handicaps which may mar its growth in future. The following are some of the problems.

vi) Unhealthy competition:

The market for leasing has not grown with the same pace as the number of lessors. As a result, there is over supply of lessors leading to competition, with the leasing business becoming more competitive, the margin.

Profit for lessors has dropped from four to five percent to the present 2.5 to 3 percent. Bank subsidiaries and financial institutions have the competitive edge over the private sector concerns because of cheap source of finance.

vii) Lack of qualified personnel:

Leasing requires qualified and experienced people at the helm of its affairs. Leasing is a specialized business and persons constituting it top management should have expertise in accounting, finance, legal and decision areas. In India, the concept of leasing business is of recent one and hence it is difficult to get right man to deal leasing business on account of this, operations of leasing business are bound to suffer.

viii) Tax consideration:
Most people believe that lessees prefer leasing because of the tax benefits it offers. In reality, it only transfers the benefit, i.e., the lessee’s tax shelter is lessor’s burden. The lease becomes economically viable only when the transfer’s effective tax rate is low. In addition, taxes like sales tax, wealth tax, additional tax, surcharge, etc. add to the cost of leasing. Thus leasing becomes more expensive from of financing than conventional mode of finance such as hire purchase.

ix) Stamp duty:

The states treat a leasing transition as sales for the purpose of making them eligible to sales tax. On the contrary, for stamp duty the transaction is treated as a pure transaction. Accordingly, a heavy stamp duty is levied on lease document. This adds to the burden of leasing industry.

x) Delayed payment and bad debts:

The problem of delayed payment of rents and bad debts add to the costs of lease. The lessor does not take into consideration this aspect while fixing the rentals at the time of lease agreement. These problems would disturb prospects of leasing business.

12. “Hire purchase”?

Hire purchase is a method of selling goods. In a hire purchase transaction the goods are let out on hire by a finance company (creditor) to 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 creditors and passes on to hirer on the payment of last installment.

13. Hire Purchaser?

Hire purchaser of hirer means the person who purchase an asset under hire purchase system

14. Hirer?

Hirer means the person who acquires or has acquired the possession of the goods from an owner under a hire purchase agreement, and includes a person to whom the hirer’s rights of liabilities under the hire purchase agreement have been passed by assignment or by operation of law.

15. Hire?

Hire means the amount payable periodically by the hirer, under the hire purchase agreement.

16. Hire Vendor?
Hire vendor or hire seller is the person who sells the goods on hire purchase system.

17. the term cash price?
Cash price or cash value of an asset is the price payable on the outright purchase of the asset.

18. “Hire Purchase Price”?
Hire purchase price is the price payable for the purchase of an asset on hire purchase system. It comprises the cash price of the asset plus in the interest payable on the unpaid balance of the cash price till the end of the period of hire purchase agreement.

19. down payment?
Down payment or advance payment means the advance paid or the cash payment made on the date of signing the hire purchase agreement.

20. total interest?
Total interest for all the installments is the total amount of interest for all the installments. It is the difference between of hire purchase price and the cash price of the asset.

21. owner?
Owner means the person who lets or has let delivers or has delivered possession of goods to a hirer under hire purchase agreement and includes a person to whom the owner’s property in the goods or any of the owner’s rights or liabilities under the agreement has passes by assignment or operation of law.

22. hire purchase agreement?
As per section 2 (c) of the hire purchase Act 1972, hire purchase agreement means an agreement under which goods are let or hire and under which the hirer has an option to purchase these goods let on hire in accordance with the agreement and also includes the following.
1. The possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments.
2. The property in the goods is to pass to such person on the payment of the last such installments and
3. Such a person has a right to terminate the agreement at any time before the property so passes.

1 Distinguish between Hire purchase and leasing
11. Ownership
12. Method of financing
13. Depreciation
14. Tax benefits
15. Salvage Value
16. Deposit
17. Rent-Purchase
18. Extent of finance
19. Maintenance
20. Reporting

11) Ownership:

In a contract of lease, the Ownership rests with the lessor throughout and the lessee (hirer) has no option to purchase the goods.

12) 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.

13) Depreciation:

Leasing, depreciation and investment allowance cannot be claimed by the lessee, in hire purchase, depreciation and investment allowance can be claimed by the hirer.

14) Tax Benefits:

The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

15) 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 Salvage Value of the asset.

16) Deposit:

Lessee is not required to make any deposit whereas 20% deposit is required in hire purchase.

17) Rent – Purchase:

With lease, we rent and with hire purchase we buy the goods.

18) 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 cost of the asset is to be paid by the hirer.

19) 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 the lessee.

20) Reporting:

The asset on hire purchase is shown in the balance sheet of the hirer. The leased assets are shown by way of foot note only.

5) Enumerate the 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 of any installment the seller has right to repose’ the goods from the buyer and forfeit the amount already received treating it as hire charge.
5. The hirer has the right to terminate the agreement any time before the property passes. There 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 sums already paid as such sums legally represent hire charge on the goods in question.

6) the condition to be fulfilled under Hire purchase Agreement?

According to the Hire Purchase Act 1972, on agreement which fulfills the following conditions, is a hire purchase agreement:
iv. The possession of the goods is delivered by the owner there of to a person on condition that such person pays the agreed amount in periodic installments;
v. The property in such goods is to pass to such a person on the payment of the last of such installment; and
vi. Such person has the right to terminate the agreement at any time before the property so passes.

Therefore the two distinct aspects of a hire purchase transaction are:

i. The option to purchase the goods at any time during the term of the agreement; and
ii. The right available to the hirer to terminate the agreement at any time before the payment of the last installment.

Thus, a hire purchase transaction is one where the hirer(user) has, at the end of the fixed term of hire an option to buy the asset at a taken value. In other words, financial leases with a bargain buyout option at the end of the term can be called a hire purchase transaction.

7) the problem of Hire purchase:

6) Taxation

7) Shortage of law-cost funds

8) Slow Market growth

9) Less Number of players

10) Increasing conservatism in the Market
1) Taxation:-
The leasing and hire purchase companies in India pay central Sales tax, Services tax of 5 per cent local sales tax of 4 per cent to 14 per cent and income tax. The industry has been asking for the removal of either sales or service tax of late, the government has recognized these activities as sale, and hence service tax on hire purchase or lease transactions is totally unjustifiable.

2) Shortage of low-cost funds:-
There is an acute shortage of low-cost funds available to hire purchase and leasing companies in the light of the stringent RBI norms. The industry feels that the banks are meeting out step-motherly treatment. This has squeezed the industry’s margins to the minimum.

3) Slow Market Growth:-
In 1997-98 the total base of leased assets in India in the formal market was estimated as US $ 37.0 billion. This value represents nominal growth of 7.6 per cent from 1996 – 97 when the value of leased assets totaled US $ 34.0 billion. The latter figure was up 20 per cent from US $ 28.5 billion in 1995 – 96.

4) Less Number of Players:-
Between 1991-94, when financial markets were booming, a large number of companies entered the leasing and hire purchase markets with little regard for the quality of clients. Since, 1996, with the market slowing, clients began defaulting on payments consequently, a number of lease financing companies faced a severe asset – liability mismatch, which led to a repayment crisis and bankruptcy.

5) Increasing conservatism in the Market:-
Since 1996, a most existing leasing company have become more conservative in their lending practices following the collapse of several leasing and hire purchase finance companies. Companies that were same what conservative to begin with have weathered the crisis and have become more conservative.
The government in response to the above problems has begin to increase its regulation of the market to ensure better compliance and prudent business practices. The step-up in regulation induded stricter requirements for deposit mobilization, capital adequacy, and registration and de-registration of NBFCs and periodic performance reviews to ensure that only financially sound companies are in the market.

8) the features of Hire purchase:
The main features of a hire purchase arrangement are as follows:

1. The hire – vendor gives the asset on hire to the hirer.
2. The hirer is required to make down payment of around 20 per cent of the cost of the equipment and repay the balance in regular hire purchase installments over a specified period of time. These installments cover interest as well as the principal repayment. In some cases, the finance company that gives hire purchase finance insists that the hirer give a deposit, which may be around 20 percent of the cost of the asset. The deposit carries interest and is returnable at the end of the hire purchase period.
3. When the hirer pays the last installment, the title of the asset is transferred from hire vendor to the hirer.
4. The hire-vendor charges interest on a flat basis. This means that a certain rate of interest is charged on the initial investment and not on the diminishing balance.
5. During the currency of the contract the hirer can opt for an early repayment and purchase the asset. The hirer exercising this option is required to pay the remaining amount of hire purchase installments less on interest rebate.
6. Theoretically the hirer can exercise the cancelable option and cancel the contract after giving due notice to the finance company.
9) Distinguish between sale and Hire purchase.

1. In the case of a sale, the ownership of the goods passes from the seller to the buyer as soon as the contract of sale is over. But in the case of hire purchase, the ownership of the goods passes from the hire seller to the hire purchaser only after the last installment is paid.

2. In the case of a sale, if the purchase fails to pay the price of goods, the seller cannot take back the goods from the buyer as the ownership of the goods had been passed from the seller to the buyer on the date of sale itself. On the other hand, in the case of a hire purchase. If the hire purchaser, as the ownership of the goods is not passed on from the hire seller to the hire purchaser till last installment is paid.

3. In the case of a sale, generally, the goods cannot be returned by the buyer. But in the case of a hire purchase the goods can be returned by the hire purchaser to the hire seller before the ownership of the goods is passed on to him.

4. In the case of a sale, the price of the goods is generally paid in one lump sum, either immediately or after sometime. But in the case of hire purchase the price of goods is paid, not in one lump sum, but in a number of installments.

5. In the case of a sale whether it is a cash sale or a credit sale, the purchaser is required to pay only the cash price of the goods. But in the case of hire purchase, the hire purchaser is required to pay the cash price of the goods plus the interest for the various installments.

6. In the case of a sale, the buyer’s position is like that of an owner. But in the case of a hire purchaser position is like that of a bailee till the ownership of the goods is passed to him.

10) the contents of Hire purchase Agreement?

Every hire purchase agreement must be in writing. It must contain the following particulars:

vi. The hire purchase price of the goods
vii. The cost price of the goods
viii. The date on which the agreement commences.
ix. The number of installments and the amount of each installment, the dates on which the installments are payable and the person to whom and the place where are installments are payable.

x. The description of the goods covered by the hire purchase agreement if the hire purchase agreement contravenes this provision can rescind the agreement by instituting a suit. As in the case of sale of Goods Act, the hire purchase Act also implies certain conditions and warranties.

13. „Factoring”

Factoring is a method of financing where by a company sells its trade debts at a discount to a financial institution, factoring is a continuous arrangement between a financial institution.

14. forfaiting?

Forfaiting is the non-recourse purchase by a bank or any other financial institution, of receivables arising from an export of goods and service.
15. **domestic factoring?**

Factoring that arises from transaction relating to domestic sales is known as domestic factoring.

16. **important functions of factoring**

Factoring simply refers to the process of selling trade debts of the company to an institution. Factoring involves the following function.

i) Purchase and collection of debts.

ii) Sales ledger management

17. **the players in the factoring arrangement?**

The buyer, the seller, the factor are the players in the factoring arrangement.

18. **“cross border factoring”?**

“Cross border factoring” involves the claims of an exporter which are assigned to a banker or any financial institution in the importer’s country and financial assistance is obtained on the strength of the export documents and guaranteed payment.

19. **types of export factoring**

i) **Two factor system**

There are two factors under the system one in the export’s country and other in the importer’s country.

ii) **Single factor system**

The export factor himself will do all the work. So it is called single factor system.

20. **Edi factoring?**

To assist international factoring, the FCI has developed a special communication system for its member called electronic data interchange factoring (Edi factoring).

21. **“International Factoring”**

“Factoring means an arrangement between a factor and his client which includes at least two of the following service to provide by the factor:

5. **Finance**

6. **Maintenances of accounts**

7. **Collection of debts and**
8. Protection against credit risks

22. Forfaiting.

Forfaiting has been defined as “the non resources purchase by a bank or any other financial institution, of receivable arising from an export of goods and service”.

23. Advantages of factoring.

3. Leverage benefit – this advantage of factoring is that it helps improve the scope of operating leverage.
4. Enhanced return - factoring is considered attractive users as it helps enhanced return.

24. Direct export factor system?

Under the system, there is a factoring agreement directly between the exporter and the exporter factor and no other party is involved. The entire export credit risk, the administration of the account, the advance payment etc. have to be done only by export factor. Hence it is called direct export factor system.

3. Explain the mechanism involved in factoring

Under the factoring arrangement, the seller does not maintain a credit or collection department. The job instead is handed over to specialized agency, called the „factor”. After each sale, a copy of the invoice and delivery challan, the arrangement and other related papers are handed over the factor. The factor, in turn, receives payment from the buyer on the due date as agreed, where by the buyer is reminded of the due determination account for collection. The factor remits the money collected to the seller after deducting and adjusting its own service charges at the agreed rate. Thereafter, the seller closes all transactions with the. The seller passes on the paper to the factor for recovery of the amount.

4. Factoring in India

There are two factoring companies in public sector banks.

1. SBI factors and commercial service ltd.
2. Can bank factor ltd.
4. SBI Factor and commercial service ltd, was floated jointly by SBI, SIDBI and union bank of India in march 1991. This factory company has become an associate member of the factors chain international,
based in Amsterdam. It also joined recently EDIFACT- which is a communication network of chain international of electronic data interchange.

5. Can bank factor ltd.

Can bank factor ltd was jointly promoted by canara bank, andra bank and SIDBI, in august 1992 to operate in south India. It paid up capital of Rs 10 cores is contributed in the ratio of 60:20:20 by its three promoters. It can have its operations throughout India due to the lifting up of restriction by RBI.

6. the characteristic features of factoring

The characteristic of factoring are as follows.


The nature of the factoring contract is similar to that of a bailment contract. Factoring is a specialized actively where by a firm converts its receivable into cash by selling them to a factoring organization.

7. Form of factoring

Factoring takes the form of a typical invoice factoring since it covers only those receivable which are not supported by negotiable instrument, such as bill of exchange etc.

8. Assignment of debts.

Under factoring, there is assignment of debt in favor of the factor. This is the basic requirement for working of factoring service.


The position of the factor is fiduciary in nature, since it arises from the relationship with the client firm.

10. Professional management.

Factoring firms are professionally competent, with skilled persons to handle credit sales realization for different client in different trade for better credit management.

8. the salient features of cross-border factoring?

The important features of this type of factoring is-

1. It is similar to export factoring, where important factor is engaged by the export factor at the debtors end.

2. It is also called „International Factoring“ or the two factor system of factoring.

3. The parties involved are the exporter, the importer, and the export factor and the import factor.

4. There are two separate inter-linked agreements, between the exporter and the export factor on the one hand, and the export factor and the import factor on the other.

5. The export and the import factors belong to a formal chain of factors, with well defined rules governing the conduct of business.
9. the advantages and disadvantages of factoring?

Advantages

1. Cost saving

It also helps in reduction of administrative cost and burden, facilitating cost saving.

2. Leverage benefit

It helps import the scope of operating leverage.

3. Enhanced return

Factoring is considered attractive to users as it helps enhance return.

4. Liquidity

It helps to avoid increased debts in case of without recourse factoring.

Disadvantages

5. Engaging a factor may be reflective of the inefficiency of the management of the firm''s receivable.

6. Factoring may be redundant if a firm maintain a nationwide network of branches.

7. Difficulties arising from the financial evaluation of clients.

8. A competitive cost of factoring has to be determined before taking a decision about engaging a factor.

10. the benefit of forfaiting

Following are the important benefit of forfaiting is:-

1. Profitable and liquid

It is very advantageous because he not only get immediate income in the form of discount charges, but also, can sell them in the secondary market or to any investor for cash

2. Simple and flexible

It is also beneficial to the exporter. All the benefit that are available to a client under factoring are automatically available under forfeiting also.

3. Avoids export credit risk

The exporter is completely free from many export credit risks that may arise due to the possibility of interest rate fluctuation or exchange rates fluctuation or any political upheaval that may effect collection of bills.
4. Avoid export credit insurance

It is very costly and at the same time it involves very cumbersome procedures.

5. Cent percent finance

The export is able to convert his deferred transaction into cash transaction through a forfaitor. He is able to get 100 percent finance against export receivables.

11. the three key elements of factoring

There are three key elements of factoring:

1. Selection of accounts.
2. Collection of accounts
3. Granting advance against receivable
4. Selection of accounts.

The factor selects accounts of a supplier to be bought on a continuous basis based on customer’s age, time of credit, quantum of amount etc. Normally the factor and the seller or supplier agree 1) on the credit limit for their customer, 2) the collection period and, 3) rebate to be charged.

5. Collection of accounts

The supplier or seller informs each customer that the factor has purchased the debt and the customer should pay only to the factor.

6. Granting advance against receivable

The factor generally advances a portion of the value of assigned debt. The balance amount is paid on maturity. By providing funds to the supplier, the factor enables him to resume production.

9. What is international factoring? Who are the parties involved in it?

International factoring is the services of a factor in a domestic business are simply extended on the basis of the invoice prepared by the exporter. International factoring is facilitated with the help of export factors and import factors.

In an international factoring transaction, there are four parties namely

1. The exporter who is taking the place of a client in a domestic transaction.
2. The importer who is taking the role of a customer in a domestic transaction.
3. Export factor.
4. **Import factor.**

The exporter and the factor enter into an agreement for export factoring may take any one of the following types:-

5. **Two factor system**

There are two factors under this system- one in the export"s country and other in the importer"s country. When the exporter wants to do business with some importer or importers, he approaches the factor in his country and informs him of his business proposal.

6. **Single factor system**

Export factor himself will do all the work. So it is called single factor system. The import factor is called upon to assist the export factor only during the times of difficulties in realizing debt.

7. **Direct export system**

Under this system, there is a factoring agreement directly between the exporter and this export factor and no other party is involved.

8. **Direct import factor system**

The agreement between the exporter and the import factor in the importer"s country.

11. the recommendation of Kalyansundaram committee.

Kalyansundaram committee was appointed in 1989 by RBI to study the feasibility of introducing factoring service in India. Accordingly in 1990 the recommendation of the committee were accepted, these are:-

- There is more scope for introducing factoring in India, especially through banks.
- Exporters can enjoy more benefits by factoring services.
- The growth of factoring will be so fast that within 2 or 3 years, it will be a viable business.
- Export factors can provide various other services also.
- All the industries as well as service can avail factoring service.
- Bank can take up factoring business due to their excellent network of branches.

12. **Distinguish between factoring and forfaiting.**

- Factoring is always used as a tool for short term financing where as forfaiting is for medium term financing at a fixed rate of interest.
- Factoring is generally employed to finance both the domestic and export business. But forfaiting is invariably employed in export business only.
- The central there of factoring is the purchase of the invoice of the client where it is only the purchase of the export bill under forfaiting.
Forfaiting is done without recourse to the client where as it may or may not be so under factoring. The bills under forfaiting may be held by the forfaiting till the due date or they can be sold in the secondary market or to any investor for cash. Such a possibility does not exist under factoring.

UNIT-5 INTRODUCTION

INDIAN STOCK MARKET

Before liberalization, Indian economy was tightly controlled and protected by number of measures like licensing system, high tariffs and rates, limited investment in core sectors only. During 1980’s, growth of economy was highly unsustainable because of its dependence on borrowings to correct the current account deficit. To reduce the imbalances, the government of India introduced economic policy in 1991 to implement structural reforms. The financial sector at that time was much unstructured and its scope was limited only to bonds, equity, insurance, commodity markets, mutual and pension funds. In order to structure the security market, a regulatory authority named as SEBI (Security Exchange Board of India) was introduced and first electronic exchange National Stock Exchange also set up. The purpose behind this was to regularize investments, mobilization of resources and to give credit.

Mark Twain once has divided the people into types: one who has seen the great Indian monument, The Taj Mahal and the second, who have not. The same can be said about investors. There are two types of investors: those who are aware of the investment opportunities available in India and those who are not. A stock market is a place where buyers and sellers of stocks come together, physically or virtually. Participants in the market can be small individuals or large fund managers who can be situated anywhere. Investors place their orders to the professionals of a stock exchange who executes these buying and selling orders. The stocks are listed and traded on stock exchanges. Some exchanges are physically located, based on open outcry system where transactions are carried out on trading floor. The other exchanges are virtual exchanges whereas a network of computers is composed to do the transactions electronically. The whole system is order-driven, the order placed by an investor is automatically matched with the best limit order. This system provides more transparency as it shows all buy and sell orders. The Indian stock market mainly functions on two major stock exchanges, the BSE (Bombay Stock Exchange) and NSE (National Stock Exchange). In terms of market capitalization, BSE and NSE have a place in top five stock exchanges of developing economies of the world. Out of total fourteen stock exchanges of emerging economies, BSE stood at fourth position with market capitalization of $1,101.87b as on June, 2012 and NSE at fifth position with market capitalization of $1079.39b as on June, 2012.

Bombay Stock Exchange

Bombay Stock Exchange is located on Dalal street, Mumbai. In terms of market capitalization, BSE is the eleventh largest stock exchange in the world on 31st December, 2012. BSE is the oldest stock exchange in India. In the beginning during 1855, some stock brokers were gathering under Banyan tree. But later on
when the number of stock brokers increased, the group shifted in 1874. In 1875, the group became an official organization named as “The Native Chor and Stock Brokers Association”. In 1986, BSE developed its Index named as SENSEX to measure the performance of the exchange. Initially, there was an open outcry floor trading system which in 1995 switched to electronic trading system. The exchange made the whole transition in just fifty days. BSE Online Trading, known as BOLT is a automated, screen based trading platform with a capacity of 8 millions orders per day. BSE provides an transparent and efficient market for trading in equities, debentures, bonds, derivatives and mutual funds etc. It also provides opportunity to trade in the equities of small and medium term enterprises. About 5000 companies are listed in Bombay Stock Exchange. As on January 2013, the total market capitalization of the companies listed in BSE is $1.32 trillion. In terms of transactions handling, BSE Ltd. is world’s fifth exchange. As far as Index Options trading is concerned, BSE is one of the world’s leading exchanges. Some other services like risk management, settlement, cleaning etc. The purpose of BSE automated systems and techniques are to protect the interest of the investor, to stimulate market and to promote innovations around the world. It is the first exchange across India and second across world to get an ISO 9000:2000 certification.

National Stock Exchange
The National Stock Exchange is located in Mumbai. It was incorporated in 1992 and became a stock exchange in 1993. The basic purpose of this exchange was to bring the transparency in the stock markets. It started its operations in the wholesale debt market in June 1994. The equity market segment of the National Stock Exchange commenced its operations in November, 1994 whereas in the derivatives segment, it started it operations in June, 2000. It has completely modern and fully automated screen based trading system having more than two lakh trading terminals, which provides the facility to the investors to trade from anywhere in India. It is playing an important role to reform the Indian equity market to bring more transparent, integrated and efficient stock market. As on July 2013, it has a market capitalization above than $989 billion. The total 1635 companies are listed in National Stock Exchange. The popular index of NSE, The CNX NIFTY is extremely used by the investor throughout India as well as internationally. NSE was firstly introduced by leading Indian financial institutions. It offers trading, settlement and clearing services in equity and debt market and also in derivatives. It is one of India’s largest exchanges internationally in cash, currency and index options trading. There are number of domestic and global companies that hold stake in the exchange. Some domestic companies include GIC, LIC, SBI and IDFC Ltd. Among foreign investors, few are City Group Strategic Holdings, Mauritius limited, Norwest Venture Partners FII (Mauritius), MS Strategic (Mauritius) limited, Tiger Global five holdings, have stake in NSE.
The National Stock Exchange replaced open outcry system, i.e. floor trading with the screen based automated system. Earlier, the price information can be accessed only by few people but now information can be seen by the people even in a remote location. The paper based settlement system was replaced by electronic screen based system and settlement of trade transactions was done on time. NSE also created National Securities Depository Limited (NSDL) which permitted investors to hold and manage their shares and bonds electronically through demat account. An investor can hold and trade in even one share. Now, the physical handling of securities eliminated so the chances of damage or misplacing of securities reduced to minimum and to hold the equities become more convenient. The National Security Depository Limited’s electronically security handling, convenience, transparency, low transaction prices and efficiency in trade which is affected by NSE, has enhanced the reach of Indian stock market to domestic as well as international investors.

Stock Market Volatility
To invest money in stock market is assumed to be risky because stock markets are volatile. There is volatility in stock market because macro economic variables influence it and affect stock prices. These factors can affect a single firm’s price and can be specific to a firm. On the contrary, some factors
listed companies came down. Volatility is the variation in asset prices change over a particular time period. It is very difficult to estimate the volatility accurately. Volatility is responsible to make the stock market risky but it is this only which provides the opportunity to make money to those who can understand it. It gives the investor opportunity to take advantage of fluctuation in prices, buy stock when prices fall and sell when prices are increasing. So, to take advantage of volatility it is need to be understood well.

If the performance of Indian stock market is seen during last 20 years, it is found that its all about only four years 2003-2007. Some people believe that investment in stock market for longer period is always give fair returns but that’s not true. According to one study, returns in September 2001 were just 49% higher as compared to returns in September 1991, a compound return that is even lesser as compared to the return on a saving bank account deposit. In the last five years, from 2007 till 2012, the total market returns are only 5.9% per year.

Source: capitalmind.in Fig 1.1: SENSEX Journey

The whole growth in stock market is attained during 2003 and 2007, besides this time period, the stock market has given only substandard returns. The scrip prices have high returns but overall stock market doesn’t raise much.

Volatility Index (VIX)

India VIX is a volatility index based on the index option prices of NIFTY. India VIX is computed using the best bid and ask quotes of the out-of-the-money near and mid-month NIFTY option contracts which are traded on the F&O segment of NSE. India

VIX indicates the investor’s perception of the market’s volatility in the near term. The index depicts the expected market volatility over the next 30 calendar days. i.e. higher the India VIX values, higher the expected volatility and vice-versa. Basu et. al. (2010) focused on explaining the merits and demerits of the volatility index (VIX). The Volatility Index (VIX) measures the implied volatility in the market using the price levels of the index options. The attractiveness of VIX stems from the fact that it is negatively correlated with the underlying index, and that it creates a new asset class which bases itself on non-directional volatility views.

Investor Sentiment and Volatility

Investor psychology plays an important role in the stock market. How an investor reacts to information and regulatory procedures of the market has an immediate effect on equity market which in turn brings volatility. Sehgal et. al. (2009) believed that better regulatory framework does influence investor sentiment especially with regard to legal provisions relating to corporate governance and investor grievance redressal mechanism. Investor sentiment and market returns were highly correlated and in fact influence each other and so with the volatility.

Causes of Volatility

There are number of factors which are contributing to stock market volatility. Some of these are as follows:

1.) Fear Factor: Fear is the reason because of which an investor can see to avoid losses. It can be few people opinion giving a trigger to sell. Fear of loss makes the investor vary defensive which results into selling. Others also feel the same and start selling at the larger level.

2.) Double –Dip Worries: There are two types of people risk taker and risk averse. Risk taker believes that market is going to be rise and there is positive signal in the market. On the other hand, risk averse feels that market can sink any time. So these mixed reactions in the equity market make it more volatile.
3.) Changes in Economic Policy: FOMC (Federal Open Market Committee) monetary policy has its influence in the market. The market receives a positive response when news arrives that Fed is going to expand its quantitative easing programme, on the contrary, negative sentiments cover the market on arriving the news of tapering of quantitative easing programme by Fed.

4.) Economic Crisis: Market reacts negatively to any major economic crisis, the more severe the crisis, the more strongly is reacted by the investors. Because of fear of loss, most of the investors start selling, and only few people take this as an opportunity to buy. Investors don’t go for fundamental and technical analysis of their portfolio instead they just got influenced by the negativity of economic crisis.

Capital Asset Pricing Model and Portfolio Returns
Capital Asset Pricing Model establishes the relationship between risks and returns in the efficient capital market. It is assumed that there is a combination effect of the parameter CAPM to determine the security/portfolio returns. Manjunatha and Mallikarjunappa (2009) showed in their study that there is variation in security returns but when beta is considered alone in the two parameter regressions, does not explain the variation in security returns.

Volatility in Indian Stock Market post liberalization
The high volatility is due to much foreign equity inflows. This results into dependence of Indian equity market on global capital market variations. It means any happening outside India will have its impact here as well. As when US economy was improving, resulted into falling rupee led negative sentiments to stock market crash. Domestic savings are lower which is increasing more foreign investments. According to RBI Handbook of Statistics (September, 2013), only 3.1% of incremental financial assets of household sector in fiscal year 2013 is invested in shares and debentures. Retail investor is participating less in equity market. Bank accounts consist of about 54% of the total household financial savings show that people want to invest less in risky assets. So, decline in domestic equity savings is biggest problem.

STOCK MARKET EFFICIENCY
It is general notion in the market that stock markets are efficient and prices reflect all available information. There is extensive research literature available to see whether stock markets are efficient or not. Some academicians believe that stock market is weak efficient (Cootner, 1962; Fama, 1965; Kendall, 1953; Granger & Morgenstern, 1970). While some others have belief that stock markets are not weak efficient (Chaudhary, 1991; Ranganatham & Subramanian, 1993). The present study is an attempt to see the efficient form of Indian stock market.

An ‘efficient’ market is defined as a market where there are large numbers of rational, profit ‘maximizes actively competing, with each trying to predict future market values of individual securities, and where important current information is almost freely available to all participants. In an efficient market, competition among the many intelligent participants leads to a situation where, at any point in time, actual prices of individual securities already reflect the effects of information based both on events that have already occurred and on events which, as of now, the market expects to take place in the future. In other words, in an efficient market at any point in time the actual price of a security will be a good estimate of its intrinsic value. (Fama, 1970)

Market efficiency is very important for any stock market because investment decisions of an investor are very much influenced by this. An investor can earn abnormal profits by taking benefit out of inefficient market whereas there is no scope of earning extra profits in an efficient market. The random walk hypothesis states that future prices are not predictable form the past. Successive price changes are not dependent over the past periods and past trends are not followed in future exactly. There is no information available in the market which is not reflected in the stock prices. Random walk basically means that prices vary randomly and there is not any significant pattern which followed in the market.
According to Jensen (1978), “A market is efficient with respect to information of it is impossible to make economic profits by trading on the basis of information.”

Malkiel (1992), “A capital market is said to be efficient if it fully and correctly reflects all relevant information in determining security prices. Formally, the market is said to be efficient with respect to some information, if security prices would be unaffected by revealing that information to all participants. Moreover, efficiency with respect to information implies that it is impossible to make economic profits by trading on the basis of information.”

Dyckman and Morse (1986) states that “A security market is generally defined as efficient if the price of the security traded in the market act as though they fully reflect all available information and these prices react instantaneously, or nearly so, and in unbiased fashion to new information”.

Types of Efficient Market Hypothesis

According to Fama (1965), Efficient Market Hypothesis suggests that security prices fully reflect all available information. There are three forms of efficient market hypothesis. These are as follows:

Weak Form Efficiency: This theory states that current prices reflect all past prices information which means if anyone has some extra ordinary information beyond this, he can earn profit by use of that information. It means that past information is reflected in stock price. Beyond past information, no information even publically available information can also have an impact on share price.

Semi-Strong Efficiency: The theory suggests that not only past prices are reflected in the current price but all publicly available information is also adjusted in the stock prices. It states that all relevant publicly available information is going to reflect in the stock price. It means if there is any new information reaches to the market, that is immediately digested by the market resulted into change in demand and supply and a new equilibrium level of prices is attained.

Strong Form of Efficiency: It states that current prices not only reflect publicly available information but insider information such as data given in company’s financial statements and company’s announcements etc. is also reflected in the present prices. For example, if company is planning to go for corporate restructuring in future, is also can’t be used by investor. All information is available to the investors and that is reflected to the market price. In normal circumstances what happens that if someone has nay private information then that person can make the profits by the use of that information by buying shares. He will continue doing that until this excess demand of shares will bring the price below, means no extra information. So he will stop to buy the shares and the stock price will be stable at the equilibrium level. This level is called strong form of market.

Efficiency and Market Returns

The all three forms of market efficiency have different consequences as far as excess returns are concerned:-

If market is weak-form efficient, no excess returns can be received on the basis of study of past prices. This type of study is called technical analysis which is based on the past prices study without any further information.

If market is semi-strong efficient, no excess returns can be received by the study of any publically available information. This study is called fundamental analysis, the study of companies, sectorals and the whole economy can’t produce much returns than expected compared to risk involved.

If market is strong-efficient, as prices are adjusted even for secret or privately held information so no excess return can be received even by insider trading.

SEASONAL ANOMALIES IN STOCK MARKET

“A seasonal price tendency is the propensity for a given market to move in a given direction at certain times of the year.” There is lots of research available which emphasized that seasonal anomalies lie in the stock market. There are different seasonal anomalies such as Monday effect or Friday effect or Day-of-the-week effect, Turn-of-the-month effect, Holiday effect, Semi-month effect, January Effect or December Effect or Month-of-the-year effect etc. Within these calendar anomalies, day-of-the-week effect and
month-of-the-year effect is analyzed under the present study. The day-of-the-week has its importance because it has its impact on the stock market volatility. If there is any king of seasonal patterns then the investor has the opportunity to take benefit out of it and earn abnormal profit.

Day-of-the-week effect
The Day-of-the-week effect means the average daily returns of all the days of the week are not the same. It is generally seen that Monday has a lower return as compared to other days Monday returns are on average lower than returns on other days known as Monday effect whereas Friday has higher returns as compared to returns of other days known as Friday effect (Cross, 1973; French, 1980; Gibbons & Hess, 1981, Jaffe & Westerfield, 1985). Fama (1965) documented that Mondays has 20% greater variances as compared to other days. There are different factors which cause day-of-the-week effect like settlement patterns, opening and closing of the market, ups and downs of the market, international factors, information etc. It is very difficult to consider any particular reason which is ultimate responsible for the seasonality in stock market. It is believed that investor prefers to sell more on Monday because he would like to adjust the impact of information received in prior week as generally bad news are released on Friday after the closing of the market. So, day-of-the-week effect is a normal practice which is observed in equity market and there is disparity on the issue whether calendar effects exist or not.

Source: Jeremy J. Siegel “Stocks for the Long Run”
Fig 1.2: Monday Effect in DJIA

Month-of-the-Year Effect
“Monthly data provides a good illustration of Black's (1986) point about the difficulty of testing hypotheses with noisy data. It is quite possible that some month is indeed unique, but even with 90 years of data the standard deviation of the mean monthly return is very high (around 0.5 percent). Therefore, unless the unique month outperforms other months by more than 1 percent, it would not be identified as a special month.”(Lakonishok and Smidt, 1988). The seasonal anomaly is Month-of-the-Year effect. It means that returns in the market are not same for all the months of the year. According to one study in US, it is found that January has higher returns as compared to other months whereas December has lower returns (Rozef and Kinnney, 1976; Gultekin and Gultekin, 1983; Keim, 1983).

January Effect
January Effect was first observed in 1942 by an investment banker Sidney B. Wachtel. The January effect means average stock prices are high in January month. The reason being is the tendency of the market where stock prices rise during last trading days in the month of the December and continue to rise in the month of January. It is believed that stock would be purchased at lower price in last days of December and sell the same at higher rates in January to earn profits.

Source: Ibbotson
Fig 1.3: January Effect in S&P 500

Causes of January Effect
Tax-Loss Selling: Stock prices come down in December because of tax reasons as some investors sell their stock in the year end to show capital loss and the same money is reinvested in the first months of the coming year (Jones, Lee & Apenbrink, 1991; Poterba & Weisbenner, 2001; Dai, 2003).
Bonus Payments: Bonus is paid by the corporate at the end of the year and the same money is used to purchase stock in the first month of year driving prices high.
Investor Psychology: Investor psychology is also playing an important role. The new year is assumed to be a new start to invest money in the market resulting higher stock prices.

Window Dressing: According to Window Dressing developed by Haugen & Lakonishok (1988), mutual fund managers sell stocks which have not performed well during the year so that they can reduce bad investments from their portfolio.

December Effect
There is evidence that traders have started purchasing some beaten up shares at the end of the year in expectation of market rise in new year. So, December is also an important month of the year, known as December Effect.

October Effect
October is treated as lowest returns month as if we look at the history it is seen that major crashes happened in October. The great depression of 1930’s started on October 29, 1929, known as black Tuesday, the day when DJIA (Dow Jones Industrial Average) declined 12% in a single day. October 19, 1987 known as Black Monday, DJIA (Dow Jones Industrial Average) declined 23%. October 13, 1989, DJIA (Dow Jones Industrial Average) declined 7% in the last hours of trading. Although, there is not any reason that why October is considered as bad month as some other months like September, 2008 when Lehman Brothers failed on March, 2000 crashed in NASDAQ market are also proved to be bad months. The present study is an attempt to identify the day-of-the-week effect and month-of-the-year effect in Indian stock market. Generally, markets have high returns during summer months, while in September, returns are less. During October, average returns are positive except in few cases like a record fall of -19.7% in 1929 and -21.5% in 1987.

Source: Ibbotson
Fig 1.4: September Effect in S&P 500

INDIAN AND INTERNATIONAL STOCK MARKETS
In the present era of liberalization, privatization and globalization, the international investments and diversification of portfolio internationally is an important issue, especially in the time period when stock markets are highly volatile. Normally, people invest in the stock market with the purpose of earning returns. An investor designs his portfolio in which he includes different stocks or group of stock on sectoral basis to achieve his purpose of maximum returns with minimum risk. International diversification can be an option as rationale behind this is that stock returns within a county can be highly correlated because of similar environment but internationally conditions can be different. On account of different factors like economic condition, political stability, tax and tariff rates and inflationary conditions, there are chances that less correlation in stock returns across different countries is possible.

In recent years, the interest in country fund especially in emerging economies has increased. Emerging markets are an attractive place for investment because of various reasons like open market system, liberal guidelines towards Foreign Direct Investment and Foreign Institutional Investment. At the time of allocation of the funds in internationally diversified portfolio, an investor would like to compare returns and risk across different countries. The benefit of internationally diversified portfolio can be enjoyed only when there is less correlation between international stock markets. Further, while constructing internationally diversified portfolio of securities, the correlation in the returns of stocks from two different countries required to be calculated. According to a report by Morgan Stanley, Indian markets are about three times more volatile as compared to other emerging markets and almost five times more than the volatility in developed markets. Other emerging markets such as China, Brazil and Russia have very less volatility in comparison to Indian market.
Contribution of Developed and Emerging Economies in Financial Crisis: A Controversial Issue

After Financial Crisis, whether the integration between emerging and developed economies has increased or not, this issue is always get attention from researchers and academicians. Few studies are in favor that integration between developed and emerging economies has increased after the financial crisis. Bahng (2003), who found that the influence of other Asian markets has increased on Indian stock market during and after the Asian Financial Crisis, this result gives an indication that Indian stock market, is moving closer towards other Asian stock markets integration. Wong et al., (2004) highlighted that there was a trend of increasing interdependence between most of developed markets and emerging markets after the 1987 market crash. After the 1997 financial crisis, the interdependence between these have gone more intensified resulted into international diversification benefits reduction. Bose (2005), found whether there are any common forces which driving the stock index of all economies or there was some country specific factors which controlling the each individual country’s economy. Indian stock market returns were highly correlated with the returns of rest of Asia and US during post Asian crisis and till mid 2004. Not only this, Indian stock market influenced some major Asian stock market returns. Co-integration between India and other market in Asian region was not very high but sufficient enough to design portfolio internationally. Huang (2013), supported that after Asian financial crisis from 1997-1999, the stock markets integration not getting weekend rather it improved and getting stronger.

Emerging and Developed economies Indices
A brief introduction of some indices from emerging economies and developed economies is given as follow:

DJIA (Dow Jones Industrial Average)
The Dow Jones Industrial Average is an index which is created by Wall Street Journal editor and Dow Jones & Company co-founder Charles Dow. It is at present owned by S&P Dow Jones Indices. It was first published on February 16, 1885. The averages are named after the name of Charles Dow and one of his business associates, statistician Edward Jones. It shows how 30 large publicly owned companies based in the United States have done in trading during a standard trading session in the stock market. Dow Jones Industrial Average is the second oldest U.S. market index after the Dow Jones Transportation Average. The Industrial part of the name is largely chronological, as most of new modern 30 companies have little or nothing to do with traditional heavy industry.

DAX (Deutscher Aktien IndeX)
The DAX is a blue chip German stock market index of Frankfurt Stock Exchange which consist of the 30 major German companies. DAX measures the performance of the Prime Standard’s 30 largest German companies by their volume and market capitalization. It is the alike FT30 and the Dow Jones Industrial Average, but because of its small assortment it does not essentially represent the economy as whole.

HangSeng
The HangSeng Index is a free float-adjusted market capitalization index. It is a weighted stock market index in Hong Kong. It is basically used to record and observe daily variation in the prices of the largest companies of the Hong Kong equity market. In Hong Kong, this is the main indicator of the overall market performance in Hong Kong. The 48 component companies of Hang Seng represent about 60% of market capitalization of the Hong Kong Stock Exchange. It was started on November 24, 1969, and Hang Seng
Indices Company Limited is currently maintaining and compiling the index. Hang Seng Indices Company Limited is a wholly owned subsidiary of Hang Seng Bank, which is one of the largest banks listed in Hong Kong in terms of market capitalization.

RTSI (Russia Trading System)
The RTS Index (Russia Trading System) is a free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow Exchange in Moscow, Russia. The RTS Information Committee reviews the list of stocks in every three months. The RTS Index value is calculated in a real-time mode. The index was introduced on September 1, 1995 with a base value of 100. In addition to the RTS Index, MICEX-RTS also computes and publishes the RTS Standard Index (RTSSTD), RTS-2 Index, RTS Siberia Index and seven sectoral indices (Telecommunication, Financial, Metals & Mining, Oil & Gas, Industrial, Consumer & Retail, and Electric Utilities). The RTS Standard and RTS-2 are compiled similarly to the RTS Index, from a list of top 15 large-cap stocks and 50+ second-tier stocks, respectively.

S&P BSE SENSEX
The Bombay stock exchange most popular index is S&P BSE SENSEX, the sensitive index is also known as BSE30. It is a index which is free-float and market weighted stock market index. BSE consist of 30 companies which are well settled and financially very strong. These companies are large and very actively traded stocks comprise different industrial sectors of the Indian economy. SENSEX from its inception has become the major indicator to see the health of Indian equity market.

The base value of S&P BSE SENSEX was decided to be 100 on 1st April 1979 and the base year taken was 1978-79. The free-float market capitalization of BSE was US$240 billion the 21st April, 2011. During the period of 2008-12, S&P BSE SENSEX market capitalization reduced from 49% to 25% because some other indices were introduced like BSE PSU, Bankex, BSE-TECK etc.

The 30 companies constituted BSE SENSEX index are continually assessed and changed according to changes in their position so that it can indicates the true market conditions. SENSEX is calculated by the use of method free float capitalization. Its different from traditional method in the sense that in free float market capitalization method, at a particular point of time, it reflects free float market value of the 3o companies proportional to the base year. To calculate the market capitalization of a company, the price of the company’s share is multiplied by the number of the shares.

FTSE Straits Times Index (STI)
The FTSE Straits Times Index (STI) is a benchmark index for the Singapore equity market. It consists of 30 companies listed on the Singapore stock exchange. It is calculated by Singapore Press Holdings, FTSE and Singapore Exchange. STI has been replaced from STII (Straits Times Industrials Index) when there was a sectoral reclassification of the companies listed in the Singapore Exchange and resulted in the removal of industrial category. STI started trading on August 1998 when STI left off.

FTSE 100
The FTSE 100 Index, also called FTSE 100, FTSE, is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. It is one of the most widely used stock indices and is seen as a gauge of business prosperity for business regulated by UK company law. The index is maintained by the FTSE Group, a subsidiary of the London Stock Exchange Group. The index began on 3 January 1984 at the base level of 1000; the highest value reached to date is 6950.6, on 30 December 1999. The FTSE 100 consists of the largest 100 qualifying UK companies by Total market value. The constituents of the index are determined quarterly, on the Wednesday after the first Friday of the month in March, June, September and December.

Nikkei 225
The Nikkei 225 more commonly called the Nikkei, the Nikkei index, or the Nikkei Stock Average is a stock market index for the Tokyo Stock Exchange (TSE). It has been calculated daily by the Nihon Keizai Shimbun (Nikkei) newspaper since 1950. It is a price-weighted index (the unit is yen), and the components are reviewed once a year. Currently, the Nikkei is the most widely quoted average of Japanese equities, similar to the Dow Jones Industrial Average. In fact, it was known as the “Nikkei Dow Jones Stock Average” from 1975 to 1985. The Nikkei 225 began to be calculated on September 7, 1950, retroactively calculated back to May 16, 1949. Since January 2010 the index is updated every 15 seconds during trading sessions.

BOVESPA
The BM&FBOVESPA is a stock exchange located at São Paulo, Brazil. On May 8, 2008, the São Paulo Stock Exchange (Bovespa) and the Brazilian Mercantile and Futures Exchange (BM&F) merged, creating BM&FBOVESPA. The benchmark indicator of BM&FBOVESPA is the Índice Bovespa. There were 381 companies traded at Bovespa as of April 30, 2008. On May 20, 2008 the Ibovespa index reached its 10th consecutive record mark closing at 73,516 points, with a traded volume of USD 4.2 billion or R$ 7.4 billion.

AORD
January 1980, the All Ordinaries (colloquially, the “All Ords”; also known as the All Ordinaries Index, AOI) is the oldest index of shares in Australia, so called because it contains nearly all ordinary (or common) shares listed on the Australian Securities Exchange (ASX). The market capitalization of the companies included in the All Ords index amounts to over 95% of the value of all shares listed on the ASX. The 3-letter exchange ticker in Australia for the All Ordinaries is "XAO". When established, the All Ords had a base index of 500; this means that if the index is currently at 5000 points, the value of stocks in the All Ords has increased tenfold since January 1980, not factoring in inflation.

Shanghai Composite Index
The SSE Composite Index is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. SSE Indices are all calculated using a Paasche weighted composite price index formula. This means that the index is based on a base period on a specific base day for its calculation. The base day for SSE Composite Index is December 19, 1990, and the base period is the total market capitalization of all stocks of that day.

LITERATURE REVIEW
Extensive researches have been done to know whether Indian stock market is volatile or not. In recent era of globalization and liberalization, the interdependence of various stock markets on each other has increased. Different factors not only national but international will increase the volatility in the market and hence the returns will also change. Lots of studies are available on this issue, support that Indian stock market volatility is persistent and spillover is present. The present study is done to fill this gap and to know the stock market volatility patterns in India. Some studies are in the favor that conditional volatility models whether symmetric or asymmetric, are able in capturing the stock market volatility.

Conditional Volatility Models
Karmakar (2005) estimated conditional volatility models in an effort to capture the salient features of stock market volatility in India. It was observed that GARCH model has been fitted for almost all companies. The various GARCH models provided good forecasts of volatility and are useful for portfolio allocation, performance measurement, option valuation etc. Because of the high growth of the economy and increasing interest of foreign investors towards the country, it is important to understand the pattern of stock market volatility to India which is time varying persistent and predictable. Banerjee and Sarkar (2006) attempted to model the volatility in the Indian stock market. It was found that the Indian stock...
market experiences volatility clustering and hence GARCH type models predict the market volatility better than simple volatility models, like historical average, moving average etc. Finally, it was seen that the change in volume of trade in the market directly affects the volatility of assets returns.

Kumar (2006) evaluated the ability of ten different statistical and econometric volatility forecasting models to the context of Indian stock and forex markets. These competing models were evaluated on the basis of two categories of evaluation measures – symmetric and asymmetric error statistics. Based on an out-of-sample forecasts and using a majority of evaluation measures find that GARCH methods will lead to Netter volatility forecasts in the Indian stock market and GARCH will achieve the same in the forex market. All the measures indicated historical mean model as the worst performing model in the forex market and in the stock market.

Karmakar (2007) investigated the heteroscedastic behaviour of the Indian stock market using different GARCH models. First, the standard GARCH approach was used to investigate whether stock return volatility changes over time and if so, whether it was predictable. Then, the E-GARCH models were applied to investigate whether there is asymmetric volatility. It was found that the volatility is an asymmetric function of past innovation, rising proportionately more during market decline.

Bordoloi and Shankar (2010) explored to develop alternative models from the Autoregressive Conditional Heteroskedasticity (ARCH) or its Generalization, the Generalized ARCH (GARCH) family, to estimate volatility in the Indian equity market return. It was found that these indicators contain information in explaining the stock returns. The Threshold GARCH (T-GARCH) models explained the volatilities better for both the BSE Indices and S&P-CNIX 500, while Exponential GARCH (E-GARCH) models for the S&P CNX-NIFTY.

Srinivasan and Ibrahim (2010) attempted to model and forecast the volatility of the SENSEX Index returns of Indian stock market. Results showed that the symmetric GARCH model performed better in forecasting conditional variance of the SENSEX Index return rather than the asymmetric GARCH models, despite the presence of leverage effect. Few are against conditional volatility models. Pandey (2005) believed that there have been quite a few extensions of the basic conditional volatility models to incorporate observed characteristics of stock returns. It was found that for estimating the volatility, the extreme value estimators perform better on efficiency criteria than conditional volatility models. In terms of bias conditional volatility models performed better than the extreme value estimators.

Kumar and Gupta (2009) investigated and identified the adequate densities for fitting distribution of first difference of change in log prices of stocks. Four different ways were adopted to test whether the first difference of log of daily closing prices follows normal or Gaussian distribution. These provided strong evidence against Gaussian hypothesis for return distributions and fat tails are observed.

Relationship between Return and Volatility
Volatility is a measure of deviation from the mean return of a security. Volatility is measured by standard deviation. When the fluctuation in prices is large, standard deviation would be high and when there is less variation in prices, standard deviation would be less. Generally, higher the risk, higher is the chances of less than expected return. If volatility increases return decreases. Stock returns are uncertain because there is volatility in stock prices. Mahajan and Singh (2008) examined the empirical relationship between
volume and return, and volume and volatility in the light of competing hypothesis about market structure by using daily data of Sensitive Index of the Bombay Stock Exchange. Consistent with mixture of distribution hypothesis, positive contemporaneous relationship between volume and volatility was observed.

Mubarik and Javid (2009) investigated the relationship between trading volume and returns and volatility of Pakistani market. The findings suggested that there was significance effect of the previous day trading volume on the current return and this implied that previous day returns and volume has explanatory power in explaining the current market returns.

Pandian and Jeyanthi (2009) made an attempt to analyze the return and volatility. It was found that the outlook for India is remarkably good. Bank, corporate and personal balance sheets are strong. Corporations are experiencing high profits. The stock market is at a record high. Commodity markets are at their strongest.

Abdalla (2012) discussed stock return volatility in the Saudi stock market. Results provided evidence of the existence of a positive risk premium, which supported the positive correlation hypothesis between volatility and the expected stock returns.

Nawazish and Sara (2012) examined the volatility patterns in Karachi Stock Exchange. They proposed that higher order moments of returns should be considered for prudent risk assessment. While there are some who believe that there is not much significant relationship between returns and volatility.

Léon (2008) studied the relationship between expected stock market returns and volatility in the regional stock market of the West African Economic and Monetary Union called the BRVM. The study revealed that expected stock return has a positive but not statistically significant relationship with expected volatility and volatility is higher during market booms than when market declines.

Karmakar (2009) investigated the daily price discovery process by exploring the common stochastic trend between the NIFTY and the NIFTY future based on vector error correction model (VECM). The results are that the VECM results showed the NIFTY futures dominate the cash market in price discovery.

Madhavi (2014) proved that stock market plays a very important role in the Indian economy. The economy directions can be measured by how the volatility index moves. Although financial industry affected by the financial crisis so stock market is perceived to be very risky place. But still, CAPM, Portfolio Diversification and APT always proved to be effective to manage the risk of market.

Time varying volatility and Negative Innovations

Mehta and Sharma (2011) focused to examine the time varying volatility of Indian stock market specifically in equity market. The findings of the study documented that the Indian equity market has witnessed the prevalence of time varying volatility where the past volatility has more significant impact on the current volatility.

Joshi (2010) investigated the stock market volatility in the emerging stock markets of India and China. The findings revealed that the persistence of volatility in Chinese stock market is more than Indian stock market.

Gupta et. al. (2013) aimed to understand the nature and different patterns of volatility in Indian stock market on the basis of comparison of two indices which are BSE index, SENSEX and NSE index, NIFTY. GARCH models were used to see the volatility of Indian equity market and it was concluded that negative
shocks do have greater impact on conditional volatility compared to positive shocks of the same magnitude in both indices i.e. SENSEX and NIFTY of the Bombay Stock Exchange and National Stock Exchange.

Volatility after the Introduction of Derivatives

Mallikarjunappa and Afsal (2008) studied the volatility of Indian stock market after the introduction of derivatives. Clustering and persistence of volatility was seen in volatility before and after the introduction of derivatives and the nature of volatility patterns altered after the derivatives.

Gahan et al. (2012) studied the volatility pattern of BSE Sensitive Index (SENSEX) and NSE Nifty (Nifty) during the post derivative period. The various volatility models were developed in the present study to get the approximately best estimates of volatility by recognizing the stylized features of Stock market data like heteroscedasticity, clustering, asymmetry autoregressive and persistence. When compared, it was found that there was difference between the volatility of pre and post derivative period. Conditional volatility determined under all the models for SENSEX and Nifty were found to be less in post derivative period than that of the post derivative period.

So, there is a gap whether there is any relationship in return and volatility as well as to see whether volatility is time varying or not. To fill this gap, the present study is done. This gives the formulation of first objective which is to see the patterns of volatility (with conditional volatility models) in Indian stock market and the effect of introduction of derivatives on stock market volatility.

Weak-Form Efficiency of Indian Stock Market

Efficiency of stock market has its implications for the whole economy and economic development of any country. As, if stock market is efficient enough then there is no need of government interference in the market movements. But, on the other side, in an inefficient market investor would like to take the benefit of extra ordinary information available to them. The role of government and the regulators increase in this situation to keep a control on significant high differences in the stock prices. Lots of research work has been done to know the efficiency of Indian stock market. Some studies are supporting that Indian stock market are not weak form efficient. Poshakwale (1996) provided evidence of day of the week effect and that the stock market is not weak form efficient. The day of the week effect observed on the BSE pose interesting buy and hold strategy issues.

Azarmi et. al. (2005) examined the empirical association between stock market development and economic growth for a period of ten years around the Indian market “liberalization” event. The data suggested that stock market development in India is not associated with economic growth over a twenty-one year study period. The results were consistent with the suggestion that the Indian Stock market is a casino for the sub-period of post liberalization and for the entire ten-year event study period.

Gupta and Basu (2007) explained that hypothesis of market efficiency is an important concept for the investors who wish to hold internationally diversified portfolios. With increased movement of investments across international boundaries owing to the integration of world economies, the understanding of efficiency of the emerging markets is also gaining greater importance. The evidence suggested that the series do not follow random walk and there is an evidence of autocorrelation in both markets rejecting the weak form efficiency hypothesis.

Chander et al. (2008) documented extensive evidence on price behavior in the Indian stock market. The random behavior of stock prices was quite visible, but could not undermine the noted drifts because randomness alone does not signify weak form market efficiency and vice-versa.

Singh (2008) studied some of the issues related to the estimation of beta. It was found that beta varies considerably with method of computation and the major reason for variation seems to be the interval
between data points. While the correlation between weekly and daily betas was very high, this was not the case with weekly and monthly betas. The variability of betas was higher with longer interval periods and more stocks were classified as aggressive when monthly returns were used.

Srinivasan (2010) examined the random walk hypothesis to determine the validity of weak-form efficiency for two major stock markets in India. He suggested that the Indian stock market do not show characteristics of random walk and was not efficient in the weak form implying that stock prices remain predictable.

Khan et al. (2011) proposed that testing the efficiency of the market is an important concept for the investors, stock brokers, financial institutions, government etc. Based on the result of runs test alternate hypothesis was rejected and it was proved that Indian Capital market neither follow random walk model nor is a weak form efficient.

Jethwani and Achuthan (2013) investigated the weak form efficiency during, before and after Financial Crisis which took place in the year 2002 (Dot Com Bubble) and 2007 (Sub Prime Crisis). The result shows that Indian stock market is not weak form efficient in all periods however after 2002 stock market behaves in more efficient manner. On the other hand, some studies reflect that Indian stock market is weak form efficient and no investor has the option to take benefit of this. Sehgal and Gupta (2007) discussed that technical indicators do not outperform Simple Buy and Hold strategy on net return basis for individual stocks. Technical indicators seemed to do better during market upturns compared to market downturns. The empirical results suggested that technical analysis provides statistically significant returns for the entire nine technical indicators on gross return basis during the entire study period.

Gupta (2010) briefed that the behavior of stock returns has been extensively debated over the past few years. The validation of random walk implied that market is efficient and current prices fully reflect available information and hence there was no scope for any investor to make abnormal profits. The result of the study indicated that the Indian stock market are weak form efficient and follow random walk.

Singh et al. (2010) aimed to present theoretical framework of efficiency of stock markets and test the Indian stock market for weak form efficiency. Statistically, the study shows that Indian stock market is weak form efficient and price changes follow a random walk.

Aggarwal (2012) emphasized that weak form of efficient market hypotheses is an area of attraction for researchers and academicians as proved by numerous studies investigating efficient market phenomenon at global level. It was found that Indian markets are random and successive index value changes are independent. The past index changes do not help the investor or analyst to forecast the future.

Rehman et al. (2012) explained that how they tested the weak-form efficiency of emerging south Asian stock markets i.e. Karachi Stock Exchange of Pakistan, Bombay Stock Exchange of India and Colombo Stock Exchange (CSE) of Sri Lanka. It was found that CSE is the Weak form efficient market.

Loomba (2012) attempted to develop an understanding of the dynamics of the trading behaviour of FIIs and effect on the Indian equity market. The study provided the evidence of significant positive correlation between FII activity and effects on Indian Capital Market. The analysis also found that the movements in the Indian Capital Market are fairly explained by the FII net inflows.
Mobarek and Fiorante (2014) determined whether the equity markets of Brazil, Russia, India and China (BRIC) may be considered weak-form efficient in recent years. The major findings indicated that the results from the last sub-periods, including the subprime crisis, support the belief that these markets may have been approaching a state of being fairly weak-form efficient, which reflects the future prospects of BRIC countries.

Bhat et. al. (2014) focused on analyzing and comparing the efficiency of the capital markets of India and Pakistan. The results derived by using various parametric and non-parametric tests clearly reject the null hypothesis of the stock markets of India and Pakistan being efficient in weak form. The study provides vital indications to investors, hedgers, arbitragers and speculators as well as the relevance of fundamental and technical analysis as far as the trading/investing in the capital markets of India and Pakistan is concerned. A gap is seen between the studies as some are in favor that Indian stock market are weak form efficient while other are against it, so this gap helped in formulating the another objective which is to seek the weak form efficiency of Indian stock market.

Seasonality in Indian Stock Market
Seasonal anomalies are a regular practice to be seen in equity market. Extensive research is being conducted to understand this. Some of the studies are supporting that there are seasonal anomalies existing in Indian stock market. Berument and Kiymaz (2001) tested the presence of the day of the week effect on stock market volatility by using the S&P 500 market index. The findings showed that the day of the week effect was present in both volatility and return equations.

Kiymaz and Berument (2003) investigated the day of the week effect on the volatility of major stock market indexes. It was found that the day of the week effect was present in both return and volatility equations. The highest volatility occurred on Mondays for Germany and Japan, on Fridays for Canada and the United States, and on Thursdays for the United Kingdom. For most of the markets, the days with the highest volatility also coincided with that market’s lowest trading volume.

Sarma (2004) explored the day-of-the-week effect o the Indian stock market returns in the post-reform ear. The Monday-Tuesday, Monday-Friday, and Wednesday-Friday sets had positive deviations for all the indices. It was concluded that the observed patterns were useful in timing the deals thereby explored the opportunity of exploiting the observed regularities in the Indian stock market returns.

Chan et al. (2004) proposed that Monday seasonal is stronger in stocks with low institutional holdings and that the Monday return is not significantly different from the mean Tuesday to Friday returns for stocks with high institutional holdings during the 1990–1998 period. The study provided direct evidence to support the belief that the Monday seasonal may be related to the trading activities of less sophisticated individual investors.

Chander and Mehta (2007) emphasized on that investors and analysts are unable to predict stock price movements consistently so as to beat the market in informationally efficient markets. It was seen whether anomalous patterns yield abnormal return consistently for any specific day of the week even after introduction of the compulsory rolling settlement on Indian bourses. The findings recorded for post-rolling settlement period were in harmony with those obtained elsewhere in the sense that Friday returns were highest and those on Monday were the lowest.

Chia and Liew (2010) studied the existence of day-of-the-week effect and asymmetrical market behavior in the Bombay Stock Exchange (BSE) over the pre- 9/11 and post-9/11 sub-periods. They found the existence of significant positive Monday effect and negative Friday effect during the pre-9/11 sub-period. Moreover, significant day-of-the-week effect was found present in BSE regardless of sub-periods, after controlling for time-varying variance and asymmetrical market behavior.
Keong et al (2010) investigated the presence of the month-of-the-year effect on stock returns and volatility in eleven Asian countries- Hong Kong, India, Indonesia, Japan, Malaysia, Korea, Philippines, Singapore, Taiwan, China and Thailand. Results obtained exhibit positive December effect, except for Hong Kong, Japan, Korea, and China. Meanwhile, few countries do have positive January, April, and May effect and only Indonesia demonstrates negative August effect.

Sah (2010) believed the main cause of seasonal variations in time series data is the change in climate. The study found that daily and monthly seasonality were present in NIFTY and NIFTY Junior returns. It was found that Friday Effect in NIFTY returns while NIFTY Junior returns were statistically significant on Friday, Monday and Wednesday. In case of monthly analysis of returns, the study found that NIFTY returns were statistically significant in July, September, December and January.

Sewraj et al (2010) investigated the day of the week effect, more precisely the Monday effect and the January effect on the Stock Exchange of Mauritius (SEM) in order to get the information whether these anomalies exist or not. The result showed that Monday effect was nonexistent in SEM. It was found that a significant positive January effect is present at market level.

Swami (2011) investigated four calendar anomalies, viz., Day of the Week effect, Monthly effect, Turn of the month effect and Month of the year effect across five countries of South Asia. The day of the week effect, was found to exist in Sri Lanka and Bangladesh; and the intra-month return regularity, in terms of Month effect and Turn of the month effect, was present in the Indian market. The anomalous behavior was not pervading across the five countries and there was little influence of one market over the other, so far as calendar anomalies were concerned.

Anuradha and Rajendran (2012) attempted to investigate whether the Foreign Institutional Investment (FII) in Indian capital market has any calendar effect in net FII(NFII), net FII in equity(EFII) and net FII in debt(DFII). After 2003, November effects were also present in both the series in addition to February effect in net FII and in equity. In the case of DFII, January effect has reappeared which has started in the month of December itself. Since the equity market was so efficient and volatile, the FII have chosen the debt instruments for assured returns. When checked for the monthly seasonality in market return, January effect is present in the first period. During the early stages of opening the market to the global players (after 1992 but before 2003), the market itself was in a developing stage and slightly in the weak form of inefficiency. That is the reason for the January effect in the first period of the study. But later on the effect has disappeared leading to the conclusion that the market has become efficient, making abnormal returns impossible. Also there exists interaction influence on the NFII in the recent period.

Siddiqui and Narula (2013) investigated the persistence of such regularities in the form of weekend effect, monthly effect and holidays effect employing twelve-year data from 2000 to 2011 of S&P CNX Nifty. The results indicated the occurrence of weekend effect in long run but reject the hypothesis of positive weekends and negative Mondays. On the contrary, the mean return on Tuesday is negative for the entire period. Instead of March effect, the study comes out with November effect and hence nullifies the ‘Tax-Loss Selling Hypothesis’. On dividing the entire period into three-year lags, anomalies instantaneously disappear confirming the fact that any seasonality takes some time to establish itself.

Sharma and Deo (2014) studied existence of the January Effect and Turn of the month year effect in the Indian stock markets. The significant April month was found and the return of March was significantly lower. This was the result of tax-loss hypothesis.
Maheta (2014) carried out this study to measure effect of festivals on the return of selected stock indices of Indian stock market. The researcher took the closing price of two indices i.e. Sensex and Nifty from January 2003 to December 2012 and applied paired t test on daily return series. The main findings of this paper are there is significant influence of festivals like Holi, Janmashtami and Diwali on the mean return of selected indices.

Few studies are not supporting that seasonal anomalies i.e. day of the week effect and month of the year effect is not present in Indian stock market. Pandey (2002) examined the presence of the seasonal or monthly effect in stock returns in Indian stock market. The statistically significant coefficient for March - the month for tax payment- was consistent with the tax-loss selling hypothesis. It was implied that the stock market in India was not informationally efficient, and hence, investors can time their share investments to earn abnormal returns.

Kaur (2004) investigated the nature and characteristics of stock market volatility in Indian stock market in terms of its time varying nature, presence of certain characteristics such as volatility clustering, day-of-the-week effect and calendar month effect and whether there existed any spillover effect between the domestic and the US stock markets. It showed that day-of-the-week effect or the weekend effect and the January effect were not present.

Deb et al. (2007) attempted to explore the market timing ability and the stock selection ability of the Indian mutual fund managers. In both traditional and conditional models it is found that there is very little evidence of market timing, particularly using the monthly data frequency. It was observed that, while the number of positive timers marginally increased, there was no improvement in the number of significant positive timers.

Mittal and Jain (2009) found that the anomalies don’t exist in the Indian stock market and this market can be considered as informationally efficient. It means that it is not possible to earn abnormal returns constantly that are not commensurate with the risk. Although the mean returns on Mondays were negative whereas the mean returns on Fridays were positive but T-test results concluded that there was insignificant difference between the returns on Monday and other week days. The Friday effect was also found insignificant while comparing Friday returns with other day’s mean returns.

Abdalla (2012) investigated the day of the week effect anomaly on stock market returns and the conditional volatility of the Khartoum stock exchange (KSE) from Sudan. The results indicated that the day of the week effect was not influenced by the stock market risk based on using GARCH-M (1,1) model.

Nageswari and Selvam (2012) investigated whether Friday effect existed in Bombay Stock Market. The analysis of seasonality results pointed out there was no significant Friday Effect existed in Indian Stock Market. A gap exists between the studies as some are in favor that Indian stock market does not have seasonal anomalies, on the other hand, others are against seasonal anomalies behavior, so this gap helped in formulating the another objective which is to know whether seasonality is present in Indian stock market or not.

**Extent of Influence of US Stock Market on Indian Stock Market**

It is believed that US stock market has influence on Asian Emerging markets and any event or happening in the US stock market affects the Asian markets returns and hence portfolio diversification opportunities exist. Ahmad et al., (2005) revealed that no long-term relationship exist between Indian stock market with US and Japanese stock markets.
Majid et al. (2008) found that ASEAN (Association of South East Asian Nations) stock markets i.e. Malaysia, Thailand, Philippine, Indonesia and Singapore are mostly influenced by the US stock market and less by Japanese stock market.

Mariani et al. (2008) briefed that long-range power correlation is in existence between emerging economies i.e. India, China and Taiwan with developed country USA.

Aktan et al., (2009) found that BRICA economies and their relation with the US stock market was identified and found that US stock market has sound effect on all BRICA economies. An unexpected shock was immediately responded by all markets and recovered themselves within a time period of five to six days.


Gangadharan & Yoonus (2012) considered that there is feedback effect from US stock market of Indian stock market means any crisis in the US has its influence on Indian stock market but there is no feedback from Indian stock market to US stock market i.e Indian stock market has no impact on US stock market. On the other hand, there is literature supporting the view that USA stock market influence on other emerging stock markets is decreasing and no long term correlation of US stock market with other emerging stock markets is found.

Gupta & Guidi (2012) examined that there was less interdependence of Indian stock market with the US market and other developed Asian markets. It was also suggested that Indian stock market is not much affected by the international events. In comparison with developed Asian markets, Indian stock market volatility is more stable which give an opportunity to international investors for investment to improve returns.

Interdependence between Developed and Emerging Economies

The integration between developed and emerging economies is increasing with the passage of time. Chattopadhyay and Behera (2006) found that contrary to general belief, Indian stock market is not co-integrated with the developed market as yet. Of course, some short-term impact does exist, although it was found to be unidirectional for obvious reasons. That is to say, the developed stock markets, viz., USA, UK and Hong Kong stock markets Granger caused the India stock market but not vice versa. However, the study did not find any causality between the Japanese stock market and Indian stock market. It was derived from the study that although some positive steps have been taken up, which were responsible for the substantial improvement of the Indian stock market, these were perhaps not sufficient enough to become a matured one and hence not integrated with the developed stock markets so far.

Dhankar and Chakraborty (2007) investigated the presence of non-linear dependence in three major markets of South Asia, India, Sri Lanka and Pakistan. It was realized that merely identifying non-linear dependence was not enough. The application of the BDS test strongly rejects the null hypothesis of independent and identical distribution of the return series as well as the linearly filtered return series for all the markets under study.

Mukherjee (2007) captured to test the correlation between the various exchanges to prove that the Indian markets have become more integrated with its global counterparts and its reaction are in tandem with that are seen globally. It is validated that in the later time periods, the influence of other stock markets increases on BSE or NSE, but at a very low almost insignificant level. It can be safely said that the markets
do react to global cues and any happening in the global scenario be it macroeconomic or country specific affect the various markets.

Mukherjee and Mishra (2007) revealed that apart from exhibiting significant annual contemporaneous measures or same day inter-market relationship among India and most of the other foreign countries, the contemporaneous feedback statistics also reveals an increasing tendency in the degree of integration among the market over a period of time, leading to a greater co-movements and therefore higher market efficiency at the international scenario.

Kumar and Dhankar (2009) made efforts to examine the cross correlation in stock returns of South Asian stock markets, their regional integration and interdependence on global stock market. It is also examined what are the important aspects of investment strategy when investment decisions are made under risk and uncertainty. Its generalized models significantly explain the conditional volatility in all stock markets in question.

Raju (2009) discussed the issues of volatility and risk as these have become increasingly important in recent times to financial practitioners, market participants, regulators and researchers. It is mainly due to the changes in market microstructure in terms of introduction of new technology, new financial instruments like derivatives and increased integration of national markets with rest of the world. First, developed and emerging markets show distinct pattern in return and volatility behavior.

Mukherjee (2011) explored the relationship between volatility within not only the Indian equity market but also within other developed and emerging markets as well. It is found that Indian market returns also affect the returns in other markets such as Japan, the Republic of Korea, Singapore and Hong Kong, China. In addition, return volatility of the Indian market does not have an increasing or declining trend, but exhibits sudden sharp increases over the Period.

Ranpura et al. (2011) examined the short-run causal linkages among equity markets to better understand how shocks in one market are transmitted to other markets and also try to study co-movement of Indian stock market index with developed as well as developing countries’ stock market indices. It can be interpreted that SENSEX is interdependent on Developed economies stock markets except NIKKEI.

Tripathi and Sethi (2012) examined the short run and long run inter linkages of the Indian stock market with those of the advanced emerging markets viz, Brazil, Hungary, Taiwan, Mexico, Poland and south Africa. It was found that short run and long run inter linkages of the Indian stock market with these markets has increased over the study period. Unidirectional causality is also found. Some of these studies are against that there is interdependence of Indian stock market with international stock markets.

Siddiqui (2009) looked at that in recent years, globalization, economic assimilation and integration among countries and their financial markets have increased interdependency among major world stock markets. Results show that stock markets under study are integrated. The degree of correlation between the markets, but Japan, varies between moderate to very high. Furthermore, it provided that no stock market is playing a very dominant role in influencing other markets.

Paramati et al. (2012) aimed to investigate the long-run relationship between Australia and three developed (Hong Kong, Japan and Singapore) and four emerging (China, India, Malaysia and Russia) markets of Asia. While bivariate Johansen co-integration test provides results in supporting the long-run relationship between Australia-Hong Kong, Australia-India, and Australia-Singapore in the post-crisis period, the causal relationship from Australia to Asian markets disappears after the crisis. Results of VAR models demonstrated that there is no consistent lead-lag association between the observed markets.
Singh and Sharma (2012) examined the inter linkages of Brazil, Russia, India and China. The results revealed that there are visible effects of stock exchanges on each other. Russian, Indian and Brazilian stock markets affect each other and also effected by each other but Chinese stock market was not affected by these markets and these markets were affected by Chinese stock market.

Dasgupta (2014) found only one co-integration, i.e., long-run relationships and also short-run bidirectional Granger relationships in between the Indian and Brazilian stock markets. It was found that the Indian stock market has strong impact on Brazilian and Russian stock markets. The interdependencies (mainly on India and China) and dynamic linkages were also evident in the BRIC stock markets. Overall, it was found that BRIC stock markets are the most favorable destination for global investors in the coming future and among the BRIC the Indian stock market has the dominance. On the basis of above, it is seen that a gap is prevalent. This gave an origin to the objective of whether Indian stock market is interdependent on international stock markets or not so that this gap can be filled.