# SYLLABUS

## B.B.A. V SEM

## Subject – Indian Financial Systems

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|---|---|
| UNIT – I | CONCEPT OF FINANCIAL SYSTEM; Formal and informal financial systems, Functions of financial system, Nature and Role of financial institutions and financial markets, Financial system and the economy. |
| UNIT – II | MONEY MARKET: Emerging Structure of Indian Money Market; Instruments of Money Market; Money Mutual Funds — An Overview and 1213I's Regulatory Guidelines; Commercial Banks — Role in Industrial Finance and Working Capital Finance. |
| UNIT – III | CAPITAL MARKET: Concept, Structure and Functions of Capital Market; Primary Market- Instruments of Issue and Methods of Flotation; Secondary Market — Concept, Market Players, trading System and Settlement. |
| UNIT – IV | INSTITUTIONAL STRUCTURE — INDIAN FINANCIAL INSTITUTION: Development Banks- FCLICICI, Sits and IDBI: Investment Institutions —UTI and other Mutual Funds; Insurance Organization- Life Insurance Corporation of India, SEI31: Scope and Functions, Objectives of SEBI. |
| UNIT – V | FINANCIAL PRODUCTS: Leasing, Hire Purchase, Factoring and Forfeiting. |
| UNIT – VI | CREDIT RATING: Meaning, Functions, Importance. DERIVATIVES: Basic Introduction |

## Unit – 1

**Concept of Financial System-**

A financial system plays a vital role in the economic growth of a country. It intermediates with the flow of funds between those who save a part of their income to those who invest in productive assets.

A financial system is a complex, well integrated set of sub- systems of financial institutions, markets, instruments and services which facilitates the transfer and allocation of funds, efficiently and effectively.

**Formal and informal Financial systems –**

The Indian financial system can be classified into the formal financial system and the informal financial system.

**Formal Financial System –** The formal financial sector is characterized by the presence of an organized, institutional and regulated system which caters to the financial needs of the modern spheres of economy. This system comes under the purview of the ministry of finance, Reserve Bank of India, Securities and Exchange Board of India and other regulatory bodies.

**Informal Financial system –** The informal system is characterized by flexibility of operations and interface relationships between creditor and debtors. The informal system consists of –

a. Individual moneylenders such as neighbours, relatives, landlords, traders, storeowners and so on.
b. Groups of persons operating as 'Funds' or 'association."
c. Partnership firms consisting of local brokers, pawn brokers and non-bank financial intermediaries such as finance, investment and chit fund companies.

**Components of formal financial system-**

1. Financial Institutions – These institutions mobilize saving and facilitate the allocation of funds in an efficient manner.
2. Financial Markets – Financial markets are a mechanism enabling participants to deal in financial claims. The market also provide a facility in which their demands and requirements interact to set a price for such claims.
3. Financial Instruments – A financial instrument is a claim against a person or an institution for the payment at a future date a sum of money and/or a periodic payment in the form of interest or dividend.
4. Financial Services- Financial intermediaries provide key financial services such as merchant banking, leasing, and hire purchase, credit-rating and so on. Financial services rendered by the financial intermediaries bridge the gap between lack of knowledge on the part of investors and increasing sophistication of financial instruments and markets.

**Functions of the financial system –**

1. Mobilisation of savings effectively
2. Savings are allocated efficiently among the ultimate users of funds (investors).
3. Increases savings by postponing present consumption.
4. Banking and financial institutions collect the domestic savings and place in the hands of the users of the funds.
5. Proper investment (productive users) is possible through the financial system.
6. The real capital formation in which the banking and financial institutions act as intermediaries to bring the savers and investors together.

**Role of Financial Institutions**

Financial institutions are business organizations serving as a link between savers and investors and so help in the credit-allocation process. Good financial institutions are vital to the functioning of an economy. Financial institutions provide three transformation services:

1. Liability asset and size transformation consisting of mobilization of funds, and their allocation by providing large loans on the basis of numerous small deposits.
2. Maturity transformation by offering the savers tailor-made short-term claims or liquid deposits and so offering borrowers long term loans matching the cash flows generated by their investment.
3. Risk transformation by transforming and reducing the risk involved in direct lending by acquiring diversified portfolios.

**Role of Financial Markets –**

A financial market is a mechanism for the exchange trading of financial products under a policy framework. Financial markets perform various functions such as –

1. Enabling economic units to exercise their time preference.
2. Separation, distribution, diversification and reduction of risk.
3. Efficient payment mechanism
4. Providing information about companies.
5. Transformation of financial claims to suit the preferences of both savers and borrowers.
6. Enhancing liquidity.
7. Portfolio management

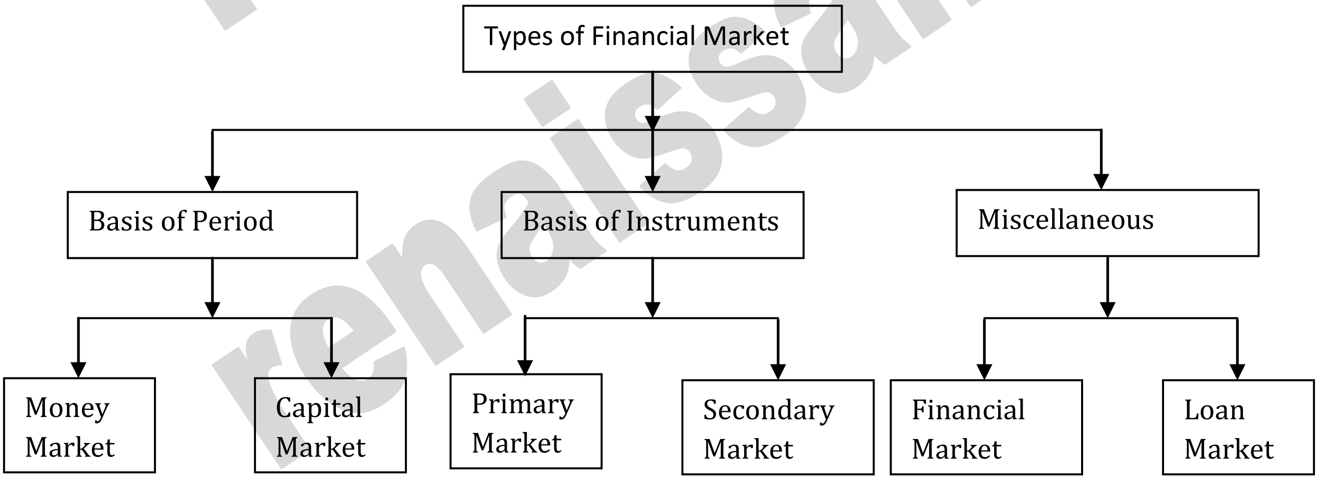
**Types of Financial Market**

Financial markets are institutions and procedures that facilitate transactions in all types of financial claims. The purchase of home, the common stock and the life insurance policy all take place in some of financial markets.

Some economic units such as households, firms or governments, spend more during a given period than they earn. Other economic units spend less on current consumption than they earth.

Financial markets exist in order to allocate the supply of savings. The main characteristic of a financial market is that it acts as the vehicle through which the forces of demand and supply for a specific type of financial claim are bought together.

The financial markets can be classified into various categories as the diversified financial transaction take place in such market. The instruments used in these markets are very basis of the classifications. The types of financial markets can be seen from the following chart –



On the basis of period of market – The financial market is classified into two categories – the transactions made on the basis of short term documents is called money market while the purchase and sale of long term documents are finalized in the capital market.

On the basis of financial instruments used – The financial market is classified two categories – when various companies and the Government issue financial instruments for the first time and they are bought and sold by financial institutions, they called primary financial markets. When the instruments are already available in the market and they are bought and sold is called secondary financial market.

Financial markets are also classified on the basis of their functions when banking institutions provide only financial services in addition to deposits and withdrawals, for example, purchase and sale of shares or securities on behalf of customers and charges are made for such services, then the market is called financial service market. When brokers or commission agents help in purchase and sale of shares and debentures and charges are made for these services the activities are covered under financial service market. When consumer credit is provided by financial institutions and terms loans are given the market carrying such activities is called loan for debt market. The loan market may be short term, medium term and long term.

**Money Market**

Meaning and Definition – Money market has been defined by different writers and authorities as given under –

1. According to Crowther, 'The money market is the collective name given to the various firms and institutions that deal in the various grades of near money."
2. R.s. Sayers has defined, "The money market properly speaking is the market for short-term and day-to-day loan."
3. According to Nadler, Heller and Shipman, "A money market is a mechanical device through which short term funds are loaned and borrowed and through which a large part of the financial transactions of a particular country to world are degraded. Money is distinct from but supplementary to the commercial system."
4. Mobilization of savings – Public savings is scattered. These savings are mobilized and collected through financial institutions. These institutions are post offices, banks, company deposits, L.I.C., U.T.I. etc. These savings are used to finance various plans. The instruments of savings account, fixed deposit accounts, recurring deposit multipurpose deposits of banks, unit of UTI and policies issued by the LIC of India.
5. Investments of savings – Financial markets not only collect and mobilize savings but they have also invested into productive uses. The rate of economic growth is accelerated by the capital formation and the rate of investment is increased for capital formation. When the competition among securities raises the price and the rate of interest is reduced. This increases investment. Thus financial markets play an important role in the management of investment.
6. Helpful to Non-financial sectors – Various types of securities are issued in capital market by the financial market. The securities comprise of shares, debentures, bonds, stock, mortgage etc. These securities are transferred in non-financial business sector by the further used in purchasing securities. Businessmen borrow money for various schemes. Thus non-financial sectors are helped by financial market.
7. Helpful to Government – Finance is made available by purchasing securities, bonds, stocks, etc. issued by the central government, state governments, local bodies and semi governments corporation in the finance market. This helps in accomplishing the various plans which were held up due to paucity of funds.
8. Economic development of country – The economic development of a country depends upon capital formation and development of each sector in the economy. Financial markets encourage savings, collect these savings and invest them in basic infrastructure – construction of roads,

dams, setting up of new industries which lead to capital formation. This generates self-reliance in each sector. Financial markets comply with the monetary and credit policies of the RBI and they are amended from time to time by which economy gets a strong base. This accelerates the capital formation and thereby the rate of economic development is accelerated.

9. Increases in Monetary Liquidity – Financial institutions operate such policies in the financial markets which maintain the monetary liquidity. For example, banks create credit and provide short term, medium term and long term loans by which the equilibrium is attained between the demand for and supply of money. The supply of working capital keeps the production cycle in process in commercial and industrial sectors. For example, purchase of raw materials, semi-production, and production, sales in the market and conversion in cash maintain the demand and supply of money.
10. Increase in Efficiency of Lenders – When there is equilibrium between demand for any supply of loanable funds in the financial markets then it is considered that the debtors and creditors are working efficiently. This situation can be attained when both the parties depend on several factors. The demand for loanable funds in the financial markets arises to investment in mortgages, stock, bonds, securities of the central government. State government and local bodies, movable capital, demand for credit is affected by several factors namely interest rates, inflation, business profit, consumer's habit, nature, change in fashion and the tax rates etc.
The supply of loanable funds is from commercial banks, savings banks, mutual funds, LIC of India, UTI, financial institutions, non-banking companies, individuals, savings organizations etc. These participants make available the funds taking into consideration the market conditions. Thus financial markets maintain the equilibrium between demand for and supply of loanable funds and consequently their efficiency increases.
11. Implementation of credit policy – Financial markets implement the credit policy and monetary policy of the Reserve Bank of India. These policies are changed from time to time which leads to full capacity utilization in the financial markets.
12. To implement monetary policy of RBI – Money market helps in implementing monetary policy of the RBI in financial market. Financial market plays an important role in the implementation of credit policy, banking and other policies.

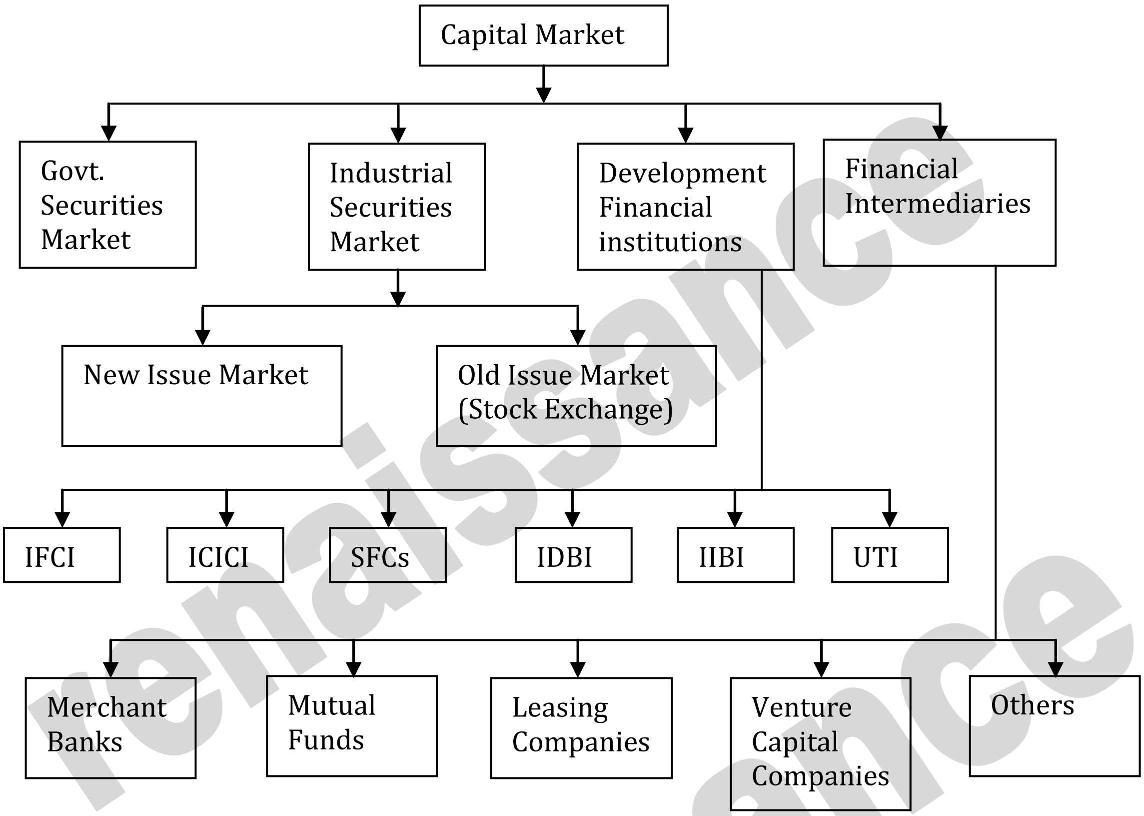
**Salient Features –** On the basis of the different definitions we can conclude that money market has the following salient features –

1. Money market deals with short term transactions.
2. These short term transactions have the duration from 1 day to one year only.
3. There are short term monetary assets in the in the money market, these comprise of commercial paper, treasury bills, deposit certificates, call money, government bills, sanctions of banks, inter-bank loans, mutual funds, bill of exchange. These assets are bought and sold in the market.
4. Equilibrium between short term demand for finance and supply of finance is attained.

In short we can say that money market is a wholesale market of financial assets wherein the short term transactions take place. Such transactions are limited to participants only.

**Capital Market**

This is one of the types of financial markets. Capital markets are the market for long term funds. Capital market refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium and long term funds). It is concerned with eh raising of money capital for the purpose of investment.




The composition of capital market can be seen from the following chart -
Capital market is composed of those who demand funds (borrowers) and those who supply funds (lenders). An ideal capital market provider's adequate capital at reasonable rate of return for any business or industrial proposition which offers a prospective field high enough to make borrowing worthwhile. The rapid expansion of the corporate and public enterprises has necessitated the developments o capital market.

Salient features – Capital market has the following salient features –

1. Capital market deals in long term transactions of securities.
2. The duration of such transactions is from 45 to 20 years.
3. The instruments used in the capital market comprise of shares, debentures, bonds, Government securities, preference shares, mutual funds, units insurance premium risk capital, lease finance and credit.
4. The loans are related to housing loan, consumer loan, mortgage loan, educational loan etc.
5. The participants in capital market are financial institutions, corporations, companies governments, commercial banks, LIC, GIC and stock Exchanges.

Foreign Exchange Market
International trade and investment would not be possible without the mechanism for buying and selling foreign currencies because the rupee is not the international means of exchange. The foreign Exchange Market (FEM) is a necessary arrangement to international transactions in an open economy. This is cleared at the exchange rate which is an important part of financial markets. The international aspects of savings and investment are reflected in the volume of capital flows between two or more than two countries.

The rate at which two countries' currencies are exchanges is called exchange rate. Foreign exchange is highly qualified claims denominated in foreign monetary units.

According to Foreign Exchange Regulation Act of 1973 foreign exchange means foreign currency and it comprises of –

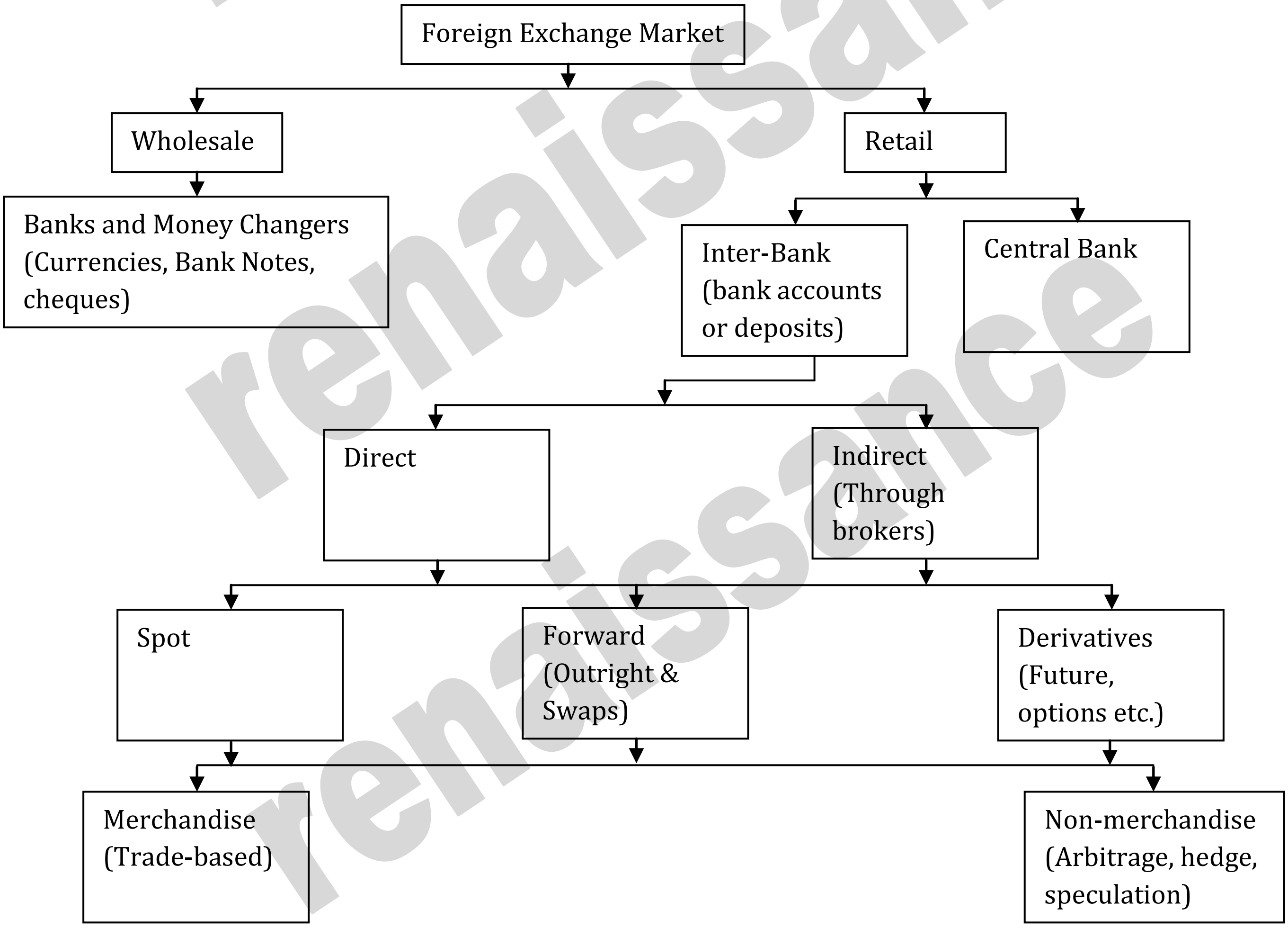
a. All deposits, credits and balances payable in any foreign currency and any drafts, traveler's cheques, letters o credit and bills of exchange drawn in Indian currency but payable in any foreign currency; and
b. Any instrument payable at the option of the draw or holder thereof or any other party either in Indian currency or in foreign currency. Thus, the market in which national monetary units is called Foreign Exchange Market. It is an informal, electronically linked network of bog banks, foreign exchange brokers and dealers whose function is to bring buyers and sellers together.

Foreign exchange market is dispersed throughout the big and small financial centres in the world. Some of these are in London, New York, Paris, Zurich, Tokyo, Milan and Frankfurt.

The organization and structure for foreign exchange market can be seen from the following chart –

Thus, we can say that Foreign Exchange Market (FEM) is the market electronically linked network of big banks, foreign exchange brokers and dealers whose functions is to bring buyers and sellers together. Trading is usually done 24 hours a day telephone, display monitors, telex and fax machines and ht satellite communications network which is a computer based communication system.

Banks have been authorized by the RBI to deal in foreign exchange and some of the financial institutions such as IDBI, ICICI, IFCI etc. have been given licence to undertake forex transactions incidental to their main business activities. The currencies are traded by the RBI on its own behalf and also on behalf of the Government.



**Salient features –** Foreign Exchange Market has the following salient features –

1. This market deals in foreign exchange
2. Foreign transactions are finalized in the market.
3. This market is dispersed throughout the big and small financial centres in the worlds.
4. This is usually 24 hours working market.
5. This market comprise retail (Banks and money changers) and wholesale (interbank and central bank.)
6. The central bank regulates and controls the dealing in foreign exchange through Foreign Exchange Regulation Act. Dealers in foreign exchange are banks, financial institutions, RBI and the Government. Authorized dealers are given licences by the central bank.

**Insurance Market**

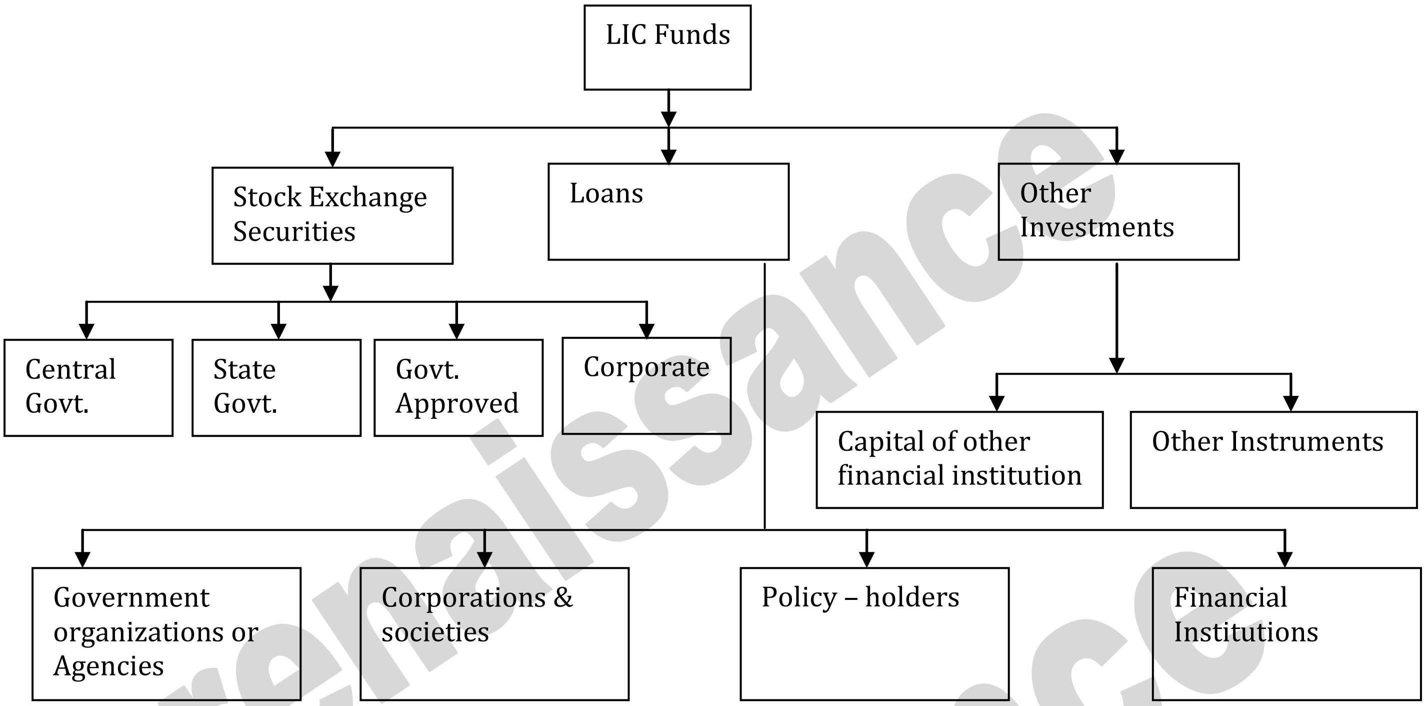
Insurance companies are financial intermediaries as they collect and invest large amount of premiums. These institutions offer protection to investors, provide means for accumulating savings, and channelize funds to the government and other sectors in the economy. Investment of insurance companies has been largely in government bonds, mortgages, state and local (municipal) government claims and corporate bonds.

Insurance companies are active in the fields, of life, health and general and they have started the pension schemes and mutual funds also. Insurance business consists of spreading risks over time and sharing them between persons and organizations. The major part of insurance business is life insurance, the operations of which depend on the laws of mortality. The insurance, the operation of which depends on the laws of morality. The basic difference between life and general insurance business is that with regard to the former, the claim is fixed and certain, but in the case of the latter, the claim is uncertain and the claim is ascertainable only some time after the event. Pension business is a specialized form of life assurance.

Thus the market where insurance business is carried on by providing policies in the fields of life, health and general to protect the interest of policy holders is called Insurance Market. Policy- holders contribute in the form of premiums to the insurance companies and get the benefits of insurance.

LIC of India and GIC of India have been mobilizing savings of the public to specifically invest in industrial securities. These institutions collect large amounts of funds from the general public to provide insurance cover but they use part of their funds to give long term loans to the corporate sector or acquire industrial securities (shares and debentures) from the market. These two institutions have become powerful operations in the stock exchange.

The major portion of the LIC's funds are required to be invested in government approved securities and socially oriented sector and only a smaller proportion is to be invested in the private sector. The broad pattern of employment of LIC's funds is given in the following chart –




Salient features – The following are the salient features of insurance market –

1. Insurance market deals in insurance business wherein the insurance companies and policy holders are the participants.
2. Insurance policies in the fields of life, health and general are issued by the insurance companies.
3. Premiums are paid by the policy-holders and they get the benefits of the policies as per the norms prescribed in the policies.
4. Insurance companies are financial intermediaries. They collect and invest large amounts o premium from the policy holders.
5. The mobilization of savings of the public are used in the long term loans to the corporate sector or acquire industrial securities (shares and debentures) from the market.
6. The major portion of insurance companies is invested in government approved securities and socially oriented sectors.

The most important event during 1999-2000 was in the field of contractual savings. The Insurance Regulation and Development Authority Act have been passed. This Act ends the monopoly of the government in the insurance sector because it seeks to promote the private sector in the insurance sector. It gives priority in the utilization of policy-holders' funds for the development of social and infrastructure funds. The government has given licences to a number of private sector companies to do insurance business.

The insurance business has been increasing in public as well as private sector providing the safety and security of life and old age benefits with protection from insurable risks in case of movable and immovable assets.

**Unit – 2**

**Indian Money Market**

Money Market provides the funds for market participants with maturity of one day to one year. The Reserve Bank of India, Commercial Banks, Financial institutions and the primary Dealers are prominent players in this market. The call/Notice Money Market provides funds for banks with a maturity range of 2 to 14 days. The market with a maturity of 15 days to one years the term money market.

Some of the characteristics of the money market are as given under –

1. The market bridges the gap between the demand for and supply of short term funds in the economy.
2. The market is a hub of activities influencing the liquidity and general level of interest rates in the economy.
3. The market facilities the landing/borrowing activities at fair and competitive rates.

**Evolution of Indian Money Market**

The Vaghul Committee, a working group of money market appointed by RBI under the chairmanship of N.Vaghul had suggested measured to develop the money market in India. The RBI has taken initiative as a follow up of the recommendations given by the Committee a sunder:

1. Discount and Finance House of India (DFHI) was set up in March' 1988 to enable liguidy of the money market instruments.
2. Widening the rage of money market instruments and introduction of new instruments like Cp] CD and interbank participation certificates during 1988-89.
3. Interest rate regulations in call money markets were adjusted to the market forces of demand and supply.

Money market is a market for short term financial assets which are near substitutes for money. Money market instruments are liquid and can be turned over quickly at low transactions cost and without loss. Money market instruments are for short duration. It is the market where the short term surplus investable funds of banks and other financial institutions are demanded by borrowers comprising individual companies and the government. Commercial banks are both suppliers of funds in the money market and borrowers.

**Objectives of money market –** There are following objectives of money market:

1. It provides an equilibrium mechanism between short term surplus and deficits.
2. The money market is focal point for central bank intervention for influencing liquidity in the economy.
3. This market provides reasonable access to users of short term money to meet their requirements.

**Importance of money market –** The money market plays an important role in trade, commerce and financial system in an economy as given under –

1. This market is an important source of financing trade and industry through bills, commercial papers etc.
2. Availability of funds and interest rates in money market have an impact on interest rates and resources mobilization in the capital market.
3. This market offers an avenue to the commercial banks for inventing short term surplus of finds and borrowing for short term needs to meet the cash Reserve Ratio (CRR) and Statuary Liquidity Ratio (SLR) requirements.
4. Money market facilitates effective implementation of monetary policy of the central banking in an economy.
5. Money market is an important guide to the government in formulating, amending and implementing its monetary policy.

6. This market provides the government an important non-inflationary measure of raising short term funds through bills subscribed by commercial banks and the public.

**Money Market players**

The transactions that take place in the money market are the high volumes. The market is dominated by a relative small number of large players. The following are the intermediaries participating in the money market –

1. Government
2. Central Bank
3. Financial Institutions
4. Corporate Units
5. Other Institutional Bodies – Mutual funds (MFs)' Foreign Institutional Investors (FIIs) etc.
6. Discount Houses and Acceptance Houses

Government is an active money market players and in most of the economies, it is the biggest in the money market. The government borrows funds when its expenditure exceeds its revenue. In such a situation government issues securities in the money market and raises funds.

Corporate also transact in the money market mostly to raise short term funds for meeting their working capital requirements. The sector utilizes both the organized and unorganized money markets.

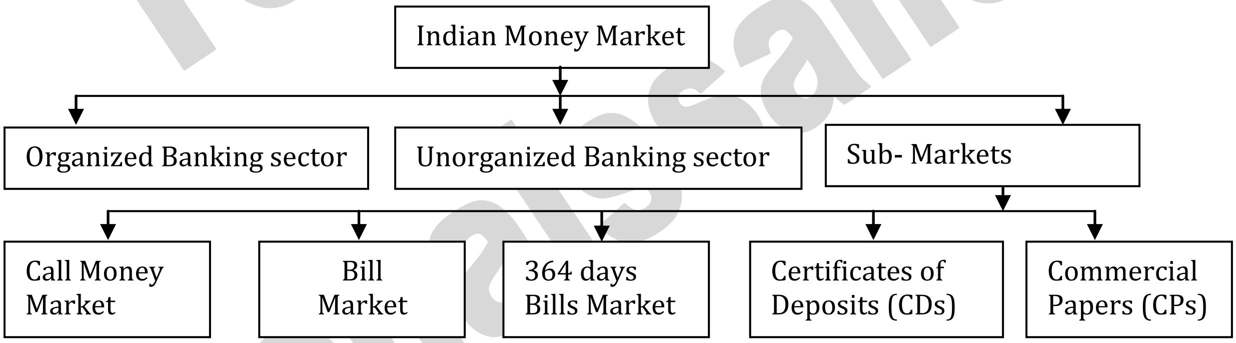
The players and their role can be seen from the following table –

**Table 1: Money Market players and their role**

| Players | Role |
|---|---|
| Central Bank | Regulatory |
| Government | Borrower/Issuer |
| Banks | Borrower/ Issuers |
| Discount Houses | Market Makers |
| Acceptance Houses | Market Makers |
| Financial Institutions (Fis) | Borrowers /Issuers |
| Foreign Institutional Investors (FIIs) | Investors |
| Dealers | Intermediaries |
| Corporate | Issues |

**Composition and structure**

The composition and structure of Indian money market can be seen from the following chart:




The Indian money market comprises of two parts:

1. The organized money market
2. The unorganized money market

The organized money market in India has a number of sub markets such as the treasury bills market, the commercial bills market and the inter-bank call money market. The organized sector comprises the Reserve Bank of India, the State Bank of India and its subsidiaries, the 20 nationalized banks and the other private sector banks in India and abroad.

The unorganized sector consists of indigenous bankers who pursue the banking business on traditional lines and Non-banking Financial Institutions (NBFIs)

Thus, the Indian money market is not a single homogeneous market but is composed of several sub-market, each one dealing with a particular type of short term credit.

Classification of Money Market Instruments
The classification of money market instrument depends upon the type of issuers and their requirements as given under –

1. Government and Quasi-Govt. Securities:
    a. Treasury Bills
    b. Govt. Dated Securities/Gilt Edged Securities
2. Banking Sector Securities
    a. Call and Notice Money
    b. Term Money Market
    c. Certificates of Deposit
    d. Participation certificates
3. Private Sector Securities
    a. Commercial Papers
    b. Bills of Exchange
    c. Inter Corporate deposits/Investment
    d. Money Market Mutual Funds
    e. Bonds/Debentures by the corporate

**Features of Indian Money Market**
Indian money market has duality. There is organized market wherein the RBI, commercial banks, private banks, development banks' SBI, Non-banking financial institutions and cooperative banks are operating. In NBFIs namely LIC, GIC UTI, IDBI, PF and Finance Corporations are working. On the other hand in unorganized part indigenous bankers and money lenders are operating.

Indian money market has the following features and defects –

1. **Existence of unorganized money market –** The major defect of Indian capital market is the existence of the indigenous bankers who provide finance irrespective of time and purpose. They are not regulated and controlled by the Reserve Bank of India. There is a whole lot of non who are generally outside the control and supervision of the RBI for the last more than 50 years.
2. **Absence of Integration –** Indian money market ha several segments loosely connected to each other. State bank of India and its subsidiaries, the foreign exchange banks, the urban cooperative banks and indigenous bankers are working independently having a particular class of business and there is absence of integration. Both commercial and cooperative banks rely on the rediscounting and borrowing facilities provided by the RBI. Lack of effective control and monitoring of commercial banking sector by the RBI had led to Harshad Mehta Scam in 1992 and Ketan Parekh Scam in 2001.
3. Difference in interest rates : Another defect of Indian money market is related to the existence of too many rates of interest. The borrowing rate of the government, the deposit and lending rates of commercial banks, deposit and lending rates of cooperative banks, the lending rate of Development Finance Institutions etc. are different in India. The basic reason is the immobility

Of funds from one section of money market to another. In recent years the different money rates of interest have been adjusting 'to changes in the bank rate.

4. Seasonal stringency of money : Another feature and defect of Indian money market is the seasonal monetary stringency and high rates of interest during a part of the year. The busy season from November to June when funds are required to move the crops from the villages and up-country districts to the cities and ports. The off-season (slack season from July to October) reflects that banks have large surplus funds and the rates of interest reach low levels. There are wide fluctuations in the money rates of interest from one period of the year to another. RBI has been trying to reduce seasonal fluctuations in the money market, by pumping money into the money market during busy seasons and withdrawing the same during off-seasons. This feature is prevailing even today.
5. Absence of Organized Bill Market – Another defect of the Indian money market is the absence of an organized bill market or discount market for short term bills. A well organized bill market is necessary for linking up the various credit agencies ultimately and effectively to RBI. The bill market was not developed due to several seasons such as the practice of banks keeping a large amount of cash for liquidity purposes, preference. of industry and trade for borrowing rather than rediscounting bills, the improper drafting of the bazar hundi, the system of cash credit as the main form of borrowing from banks, the preference of cash transactions in certain line of activity the absence of warehousing facilities for storing agricultural produce and the high stamp duty on usance bills.
   The bill market scheme introduced by the RBI in 1970 has not developed fully as was anticipated. Treasury bill market, commercial paper, call money market, repos are backward in the country which have not developed the money market in India.
6. Highly volatile call money market: The call money market is the market for short term funds known as "money at call and short notice". This market comprises at the call market or overnight market and short notice market. The rate of which funds are borrowed in this market is called the call money rate. Call money rates are market determined. The demand for short term funds comes from public sector banks (80% of borrowing) and foreign banks and private Sector banks account for 20% only, while some banks operate both as lenders and borrowers, other operate only as borrowers or only as lenders. The suppliers of funds in the call money markets are mostly non-banking financial institutions such as IDBI, GIC etc. (80% of the funds) and remaining 20% of the funds by the banks in the call money market.
   RBI had tried to moderate the fluctuations in the call money rates, these are even today highly volatile.
7. Lack of a well-organized Banking system : There is a lack of well-organized banking system in Indian money market. Branch expansion was very slow before the first major nationalization of commercial banks in July 1969. There are only a few big banks in the country and they are concentrated in large towns and mandies.
   Harsha Mehta Securities Scam in 1992, Ketan Parekh Scam of 2001 and CM Agarwal of Home Trade in the Gilt-edged Market of 2002 have revealed that the Indian banking system is not a well-organized and efficiently supervised system.
8. Lack of credit institutions : There are few credit institutions in Indian money market. UTI, LIC of India, GIC, commercial banks, financial institutions are some of the credit institutions. But these institutions are operating in cities and large towns while credit facilities are not available in rural areas. Money market has not developed due to lack of such credit institutions.
9. Limited availability of credit instruments: Till. 1985-86 there was a limited number of adequate short term paper instruments in Indian money market. There were treasury bill market and Call money market. There were no specialist dealers and brokers dealing in different segments of the Indian money market and in different kinds of paper instruments. RBI started introducing new paper instruments such as 182 days treasury bills, 364 days treasury bills, certificates of deposits (CDs) and commercial papers (CPs) after 1985-86.

**Suggestions for Improving Indian Money Market**

The following remedial measures can be suggested to improve Indian money market:

1. Control over indigenous bankers: In order to have a well organized and well developed money market in our country the money lenders and indigenous bankers spreading in rural areas should be controlled. RBI should adopt some effective measures to regulate and control the activities of this unorganized sector.
2. Standardization of Hundies: The Hundies used by indigenous bankers are not accepted by commercial banks. They should be standardized. in order to bring uniformity in Hundies Banking Commission had recommended the Sight and Time Hundies. It will make the transactions easier in the money market.
3. Establishment of financial institutions: Money market can be well developed only where there is a chain of financial institutions. These institutions are acceptance houses, finance and discount houses, credit institutions etc. The establishment of such financial institutions will solve the problems of short term finance in the money market.
4. Development of bill market: Reserve Bank of India should issue new directives to develop bill market in the country. For this purpose the following measures are suggested :
   a. To increase the business through bills.
   b. To reduce the stamp duty
   c. To establish clearing houses
   d. To reduce the discount rates
   e. To set up acceptance houses
   f. To set up more warehouses
   g. Acceptance of bills on the security of crops.
   h. Uniformity And Standardization of Hundies
   i. Repayment facilities of bills.
5. Development of banking operations: The development of banking operations is essential for the development or money market. The -expansion of bank branches will increase the banking operations.. Money market will be developed on strong lines when credit facilities are made available in urban and rural areas, collection of savings, investment of mobilized savings, make available finance and short term finance without securities in the country.
6. Establishment of Clearing Houses: Clearing Houses should be established to take advantage of banking facilities. The branches of banks are being expanded on the one hand but the numbers of clearing houses are very few. It takes time in getting the payment through commercial bills.
7. Facilities of money transfer: There should be facilities of money transfer from financial institutions on the minimum cost in order to develop organized money market. The lower the cost of money transfer the more will be the demand for finance and trade and industries will be given sufficient funds.
8. Expansion of money market: The money market facilities are limited to large cities and towns only. These facilities are to be extended throughout the country. Banking facilities, clearing houses facilities, acceptance houses' facilities and facilities of discounting of bills should be extended to small towns and cities to develop the money market.
9. Development of secondary market: The development of money market presupposes the development of secondary market. Securities are bought and sold in secondary markets. Such securities are of long duration. When secondary market is developed the money market will automatically develop.
10. Control on chit fund companies: Chit fund companies carry a big business in private sector. These companies attract the members to pay various types of incentives but after sonic time these companies are closed and the amount collected are taken away and there is no whereabouts of such companies. A new act should be enacted by the RBI to control such chit fund companies in order to develop money market.

Thus the above suggestions will go a long way in the development of money market in our country.

**Composition of money market**

a. **Call money market-** Call money market is a segment of the money market where scheduled commercial banks lend borrow on call or at short notice (1 day to 14 days) to manage the day to day surplus & deficits in their cash flows. It is primarily centralized in Mumbai with sub markets in Delhi, Kolkata, Chennai, Ahmedabad. Current and expected interest rates on call money are the basic rates to which other money markets and to some extent the government securities market are anchored. The participants in the markets are commercial banks, co-operative banks & primary dealers who can borrow and lend funds. Larger mutual funds promoted by nationalized banks, private sector mutual funds and all India financial institutions can participate in market as lender only.

b. **Commercial bill market -** Bills of exchange are drawn by the seller on the buyer for the value of the goods delivered by him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. One of the methods used by the bank for providing credit to customers is by discounting commercial bills at a negotiated discount rate. This discounted bills can be rediscounted by the bank in the commercial bills Discount Market. The rate of discount was governed by a directive from the RBI, which had stipulated a ceiling rate of 11.5%. The proportion of bills to total bank rate declined from 10.5% in 1978 to 4.8% in Feb 1991.

c. **Acceptance Market-** refers to the market where trade bills are accepted by financial intermediaries. All trade bills cannot be discount easily because the parties to the bills may not be financially sound. In such case the bills are accepted by the financial intermediaries sot that the bills earn a good name and reputation and then such bills can be readily discounted anywhere.

d. **Treasury bill market-** A TB is basically an instrument of short term borrowing by the government of India. TBs are issued in lots of Rs. 25000 for 14 days and 91 days and Rs. 100,000 for 364 days TBs. TBs are approved securities for SLR. Features of TBs are:
   1) Govt. contribution to the money market
   2) Mop up short term funds in the money market
   3) Sold through auctions
   4) Discount rate is market driven and
   5) Focal point for monetary policy.

   There are two types of bills: (i) Ordinary/ regular bills- issued to the public/ financial institutions. These are freely marketable & can freely bought & sold. (ii) Adhocs bills are always issued in favour of the RBI only. They are not marketable in India. However the holders of these bills can always sell them back to the RBI.

e. **Certificates of Deposits Market –** Certificates of Deposits are marketable receipts in bearer or registered form of funds deposited in a bank for a specified period at a specified rate of interest. They are different from the fixed deposits in the sense that they are freely transferable, can be sold to someone else and can be traded on the secondary market. They are liquid and riskless in terms of default of payment of interest and principle.

f. **Commercial Paper Market –** Commercial paper (CP) is a short-term instrument of raising funds by corporate. It is essentially a sort of unsecured promissory note sold by the issuer to a banker or a security house. Maturity of his instrument is flexible depending upon needs of borrower and lender. Highly rated corporate, capable of raising fund at lower the banks lending rates, issue such papers.

**Acceptance House**

In London, there are specialist firms called acceptance houses which accepts bills drawn by traders and import greater marketability. In India there are no acceptance houses. The commercial banks undertake the acceptance business to some extent.

**Discount houses**

In some countries there are some financial intermediaries who specialist in the filed of discounting. For eg, In London money market there are specialized institution called discount houses which specializes only in the field of discounting bills. Such institutions are conspicuously absent in India. Hence commercial banks in India have to undertake the work of discounting. However, the DFHI has been establishes to activate this market.

**Recent Development in Money Market**

**(i) Debt. Securitization :** The buzzword in the money market is now debt securitization which refers to converting retail loans into whole sale loan and their reconverting into ret loans. The philosophy behind the arrangement is that an individual body cannot go on lending sizable amount for about a longer period continuously but if the loan amount is divided in small pieces and made transferable like negotiable instruments in the secondary market, it becomes easy to finance large projects having long gestation period. The Industrial Credit and Investment Corporation of India (ICICI) as well as other private financial companies have been trying similar deals for lease rentals. Some finance companies are also following the same route for financing promoters contribution for projects. The HDFC has entered into an agreement with ILFS to securities its individual housing loan portfolio to the extent of Rs. 100 crores.

In India beginning was made to a limited extent, by introducing Inter-bank Participations (IBPs). In October, 1988, two types of IBPs were introduced (i) a risk bearing IBP with 91-180 days maturities, and (ii) non-risk bearing IBP with maturities upto 90 days.

**(ii) Money Market Mutual Funds (MMMFs) :** One of the recent development in the sphere of money market is the establishment of Money Market Mutual Funds, the guidelines of which have been made public by the Reserve Bank of India. Money Market Mutual Funds (MMMFs) can be set up by the banks and public financial institutions. There can also be Money Market Deposit Accounts (MMDAs). The limit for raising resources under the MMMF scheme should not exceed 2% of the sponsoring bank's fortnightly average aggregate deposits during 1991-92. If the limit is less than Rs. 50 crores for any bank, it may join with some other bank and jointly set up MMMF. In the case of public financial institutions, the limit should not exceed 2% of the long term domestic borrowings as indicated in the latest available audited balance sheets.

**(iii) Repurchase Options (Repo.) and Ready forward (RF) contracts :** Under this transactions the borrower places with lender certain acceptable securities against funds received and agrees to reverse this transaction on a pre-determined future date at agreed interest cost. Generally repo-transactions are for minimum period of 14 days and maximum period of 1 year. The transactions can be undertaken by commercial banks, financial institutions, brokers, DFHl) Nand Kami panel set up for examining transactions in PSLJ bonds and UTI units have recognised the importance of this instrument as a money market instrument and recommended its re-introduction. Repo or ready-forward deal, is a sale of RBI- approved securities (or repo securities) by a bank to another bank, or STCI or DFHI, with a commitment to repurchase the same at an agreed future date.

## Unit 3
## Capital Market

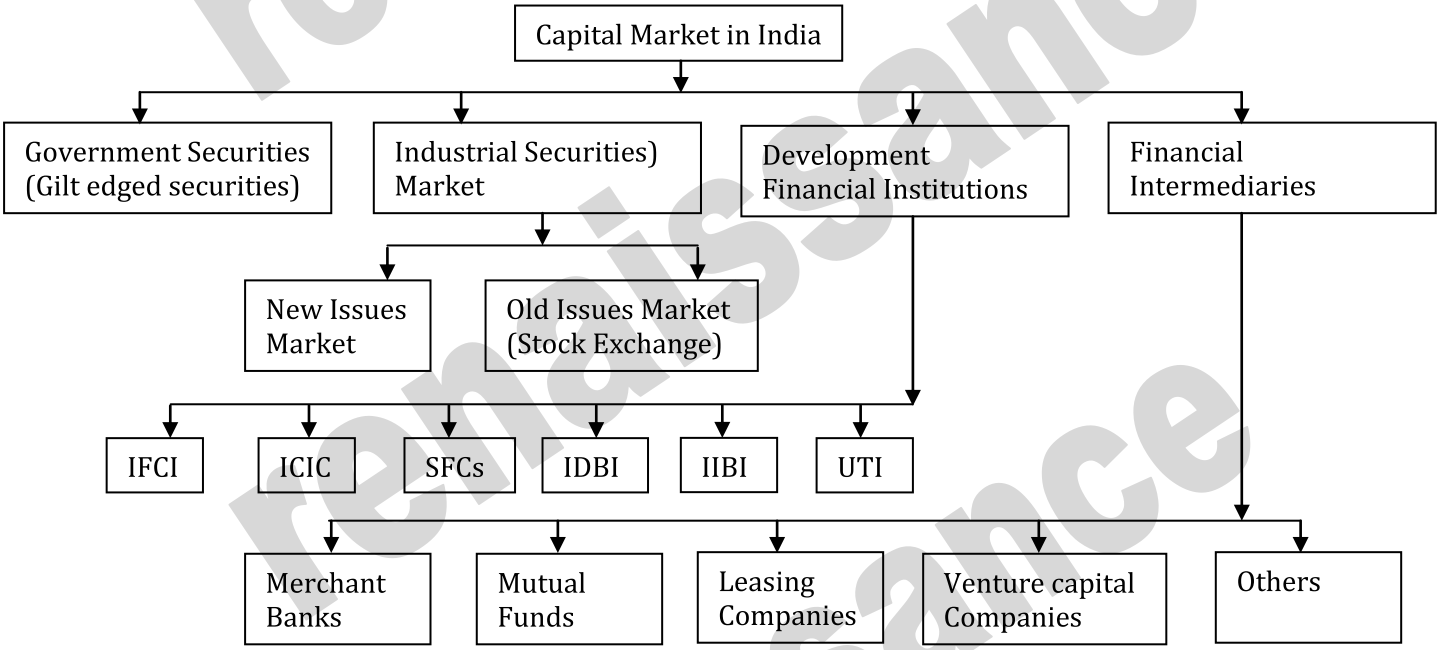
On the basis of period of market the financial market can be classified into two categories namely money market and capital market.

**Meaning of capital Market** – A Capital Market is the market for long term funds, just as the money market deals with the short term funds. This market deals with all the facilities and the institutional arrangements for borrowing and lending term funds (medium and long term funds). Capital market does not deal in capital goods but is concerned with the raising of money capital for purpose of investment.

**There are two sides of the capital Market as given under –**

1. The demand for funds – in capital market comes predominantly from private sector manufacturing industries and agriculture and from the government largely for the purpose of economic development. Central and state governments are investing not only on economic overheads as means of communication and transportation, irrigation even consumer goods industries, they require substantial funds from the capital market.
2. The supply of funds – for capital market comes from individual savers, corporate savings, banks, insurance compane4is, specialized financing agencies and the government.

**Composition – The composition of capital market in India can be seen from the following chart :**




Thus the above chart shows that a large number of participants in the capital market are involved dealing with government securities, industrial securities, development financial institutions and financial intermediaries. There are various sources of funds dealing with demand for funds and supply of fund in the capital market.

**Nature and importance of Capital Market**

1. It provides long term funds which are needed for providing basic infrastructure and to accelerate the rate of economic growth.
2. The market has various types of instruments through which funds are mobilized. These instruments are shares, debentures, bonds, bonus, government securities, preference share, mutual funds, units insurance premium, leasing finance etc.

3. The participants in the capital market comprise of financial institutions, corporations, companies, governments, commercial banks, LIC of India, GIC of India, Stock exchange centres etc.
4. Capital market comprises of primary market wherein new issues are floated for the first time namely shares, debentures, bonds, public bonds etc. Secondary market wherein the old issues are bought and sold which comprises of industrial security market (Stock Exchanges) where industrial securities are bought and sold and gilt edged market in which the government and semi government securities are traded.
5. Capital market brings the suppliers and buyers of funds together for the long term transactions. It leads to maximization of long term funds for ameliorating the conditions of the people by generating employment opportunities and overall balanced development of the country.

**Institutions of Capital Market :** The participants in the capital market are as given under :

1. Commercial banks both in private and public sector.
2. LIC of India and GIC of India are investment banks mobilizing stall savings and putting such savings into productive channels.
3. Provident funds as a major source of savings and they are invested into government securities.
4. Development banks provide long term finance in the capital market. A large number of such institutions have been created by the government of India at the national level and by the states at the state level. The institutions comprise of IFCI, ICICI, IDBI, IIBI, UTI, SIDBI. They provide long term capital to the private sector. State Finance Corporations and Industrial Development Corporations have been set tip by the state governments.
5. There are financial intermediaries in the capital market. They are merchant banks, mutual funds, leasing companies, venture capital companies etc. These institutions help in mobilizing savings and supplying funds to the capital market.

Thus all markets, the capital market comprises of those who demand funds (borrowers) and those who supply funds (lenders) in the economy.

An ideal capital market provides adequate capital at reasonable rate of return for any business or industrial proposition which offers a prospective yield high enough to make borrowing worthwhile.

The rapid expansion of the corporate and public enterprises during planning period has necessitated the development of the capital market in India. Central government, state governments and local bodies are also participating in the capital market.

Capital market through stock exchange centres purchases and sales shares, debentures, bonds, stocks and other securities. Thus it is a group of various institutions which make capital available through medium and long term securities.

**Instruments of Capital Market**

The various institutions in the capital market carry their transactions through various instruments. These instruments are varied in nature. The maturity period, rate of interest, dividend rate, ownership and voting right are the salient features which vary from one instrument to another. The following are the instruments in the capital market :

1. **Government securities :** Government bonds, securities, debentures are issued by the central, state and local bodies. Government securities are called gilt edged securities as they are more safe and liquid in comparison to other securities. These securities are long term which are sold to financial institutions, banks and the public to collect funds.
2. **Corporate stock :** Such stock comprise of preference shares, bonus shares, ordinary shares, stocks, bonds, debentures and bonds issued by public sector enterprises.

3. **Mortgage Loan :** Under this instrument loans are taken for purchasing house, plant, land, farm-house, business by mortgaging the papers of ownership. Land Development Banks provide long term credit to farmers for purchasing tractor, land and for permanent improvement on land. Such institutions involved in mortgage loan are commercial banks, housing construction institutions, insurance companies, financing companies etc.
4. **Consumer and Commercial loans :** Loans are also made available in capital market for consumption and commercial uses. For example cars, motor cycles, scooters; TVs, freeze, air conditioners, home theaters, VCR, VCD and other electronic equipments for which consumer loan is made available in the capital market. Similarly commercial loans are taken by the traders and businessman. Both of these instruments are related with medium term finance.
5. **Infrastructure bonds :** In recent years infrastructure bonds are being issued in the capital market to provide infrastructure facilities in the economy. The& bonds are tax saving devices which are being issued by different financial institutions. ICICI, IDBI, NABARD and other corporations are raising funds through such instruments.
6. **New Instruments :** New instruments have been issued in the capital market particularly after 1992. They are convertible preference share, secured premium bonds, warrants, zero coupon bonds, discount bonds, flexi bonds, regular income bonds, money multiplier bonds, floating rate bonds etc.
7. **Foreign bonds :** Multinational companies and other large sized foreign companies have also issued bonds and financial instruments in many capital markets of the world which are in the currency of the country concerned. They are also sold in Indian money market.

Indian companies are issuing financial instruments in foreign capital market of 5 to 9 years duration. Foreign money bonds, Foreign Money Notes, Euro Money Bonds, Convertible Bonds etc. Thus the funds of private companies and public enterprises have enlarged.

**Recent Trends in Capital Markets**

Economic Reforms in India were introduced with effect from July 1991 and thereafter there has been some trends in the area as given under:

1. **Disintermediation —** The major impact of economic reforms led to disintermediation in the capital markets. There has been a major shift from traditional sources of funding to hold initiatives in the capital markets: They corporate sector has directly accesses the market and rely on institutional and bank borrowing has reduced. The abolition of the control on capital issues by the government in 1992 has given a big boost in this direction.

   The institutionalization of the market has showed the qualitative improvement in the intermediation services and disclosure standards. The institutional investors have a greater pressure on the companies they invest in, to improve the quality of corporate governance.
2. **Institutionalization—**Another major, trend in the capital markets is the institutionalization. Institutional entities have affected the markets to a large extent. Mutual funds, foreign institutional investors, financial institutions, venture capital funds, Private Equity funds, Debt Funds, Portfolio managers are some of dominant players in the capital-markets. Intermediaries like Brokers and Merchant Brokers are emerging the corporate entities. The entry of pension funds and provident funds in the market has further accelerated this process.

   Institutionalization of, the market has improved the quality of intermediation services and disclosure standards.
3. **Globalization —** Indian capital markets have been gradually integrated with the global markets: The process of globalization started with the opening of our capital markets to foreign portfolio investment. Institutional investors like foreign Mutual Funds and Pension Funds are permitted to invest. The ceiling for investment by Non-Resident Indians (NRIs) and overseas corporate Bodies (OCBs) in Indian Companies have also been increased. The government of India has also allowed Indian Mutual Funds to invest in foreign markets as a part of global diversification investment.

**Returns in Primary Markets**

The economic reforms introduced in the area of modernization of the market. The main drawback of capital markets. in India was the prevalence of obsolete systems and practices 'Modernization Comprises of replacing these with new Systems which are in line with those existing in advanced capital markets of the world. Technology has played an important role in the whole process. Some of the steps undertaken by the government are as given under:

1. Free Pricing—Office of the Controller of Capital Issues has been abolished which is a new era in the primary markets. All controls relating to pricing, designing and tenure of the instruments have been abolished. A variety of instruments were designed meeting the specific requirements of the issuers and investors. The issuers are free to price the instruments. The determination of pricing was left on the free economic forces of demand and supply.
2. Entry Norms —There was a massive surge of small cap issues. Many of the companies were promoted by persons with dubious credentials. The shares of such companies were not even traded in the secondary markets after listing. Several investors incurred heavy losses by investing in such shares. It was realised that there should be transparency in the initial stage. Stock Exchange Board of India (SEBI) introduced eligibility norms in the form of dividend track record for existing companies and compulsory appraisal of projects of new companies.
3. Disclosures--The quality of disclosures in the offer documents was extremely poor. SEBI has introduced stringent disclosure norms. Most of the recommendations of Malegam Committee on the levels of disclosures by Indian issuers have been implemented. The very object of it was to'inake Indian disclosure norms conform to global standards.
4. Book Building—This is related to the process of price discovery. One of the defects of free pricing was the price mechanism through the free play of economic forces of demand and supply. The issue price had to be decided around 60-70 days before the opening of the issue. It will help in overcoming the market prices of securities.
5. Streamlining the Procedures — SERI has issued guidelines to ensure uniform procedures. Many aspect of the Operations have been made more transparent.
6. Registration of intermediaries — SEM introduced the process of registration of some of the intermediaries associated with the process of issue management. It has ensured professionalization of the intermediaries and to curb the malpractices indulged by some of the intermediaries. The registration has been made mandatory for the following primary market intermediaries.
   - Merchant Bankers
   - Registrars and share Transfer Agents
   - Brokers to the Issue
   - Bankers to the Issue Debenture Trustees

**Recent Trends in the Primary Markets**

The primary market experienced a major boom after the economic reforms initiated in bur country in July, 1991. There has been a tenfold increase in the number of Public issues from 141 in 1990-91 to 1428 issues in 1995-96. The total capital mobilised also increased by seven fold from Rs. 1704.35 crore to Rs: 11822.18 crore during the same period. But there has been a sharp fall in both the number of public issues and amount mobilised in the market often 1995-96. The number of issues has fallen from.1428'in 1995-96 to 62 in 1997-98. The capital raised had also fallen front Rs. 11822.18 crore in 1995-96 to Rs. 3061 crore in 1997-98. This downward trend in the capital mobilisation in the primary market continued till the end of 1997-98 and was reversed in 1998-99. During 1998-99, the total amount of capital raised through public issues rose steeply to Rs. 5018.9 crore from Rs. 3061 crore. The average size of the issue during 2000.01 was Rs. 40.44 crore as aghast Rs. 84.05 crore in 1999-00.

**Distinction between Money Market and Capital Market**

The difference between Money Market and Capital Market can be studied as given under :

| Basis | Money Market | Capital Market |
|---|---|---|
| 1. Securities | Short term transactions of securities | Long term transactions of securities |
| 2. Period | The duration of securities is one year or less than one year | Long term securities of 15 to 20 years. |
| 3. Instruments | Promissory Note, Bill of Exchange, Treasury Bill, Call Money, Deposit Certificate etc | Shares, Debentures, Bonds, Bonus, Govt. Securities, Rights Share, Mutual Funds, Units, Insurance Premium, Risk Capital, Leasing Finance etc. |
| 4. Objectives | Funds are demanded for short term requirements. It meets the working capital requirements. | Funds are needed for long term requirements. House loan, consumer goods credit; . mortgage loan, education loan etc. |
| 5. Institutions | Firm, companies, corporations, government, farmers and individuals are participants in the market. | Corporation, companies,. governments, commercial banks, .LIC, GIC and Stock Exchange centres. |

Thus we can say that various participants in both the markets are common. Investors invest their money in securities for short term and long term period. The interest rates in money market affects the interest in capital market: The short term securities are converted into long term securities after their maturity.

**Secondary Market : Stock Exchange**

In a secondary market the existing securities are bought and sold. This market is called Stock Exchange because shares, debentures, bonds, stocks etc. are bought and sold through Stock Exchange Centres. There is a large number of non-banking intermediaries participating in the market. These participants comprise of UTI, LIC, GIC, Mutual Funds, .brokers, underwriters, sub-brokers; jobbers, merchant banker, Stock Exchange centres, National Stock Exchange, Leasing Finance Company, Over The Counter Exchange of India (OTCEI) etc.

**Definition of Stock Exchange**

Stock Exchange is an organised and permanent market wherein securities issued by joint stock companies, public utilities, government, semi-government corporations, public enterprises are bought and sold.

Some other definitions of sock exchange are discussed as given under :

1. According to Pyle, "Stock Exchanges are market places where securities that have been listed thereon may bought and sold for either investment or speculation."
2. Section 2(i)3 of Securities' Contract (Regulation) Act of 1956 defines, "Stock Exchange means anybody of individuals whether incorporated or not constituted for the purpose of assisting, regulating or controlling the business of buying or dealing in securities."
3. According to Gerstenberg, "The stock exchange are organized auction market where buyers- and sellers come together, through their brokers, to effect transactions insecurities admitted to listing on the exchange and unlisted securities for which a market is maintained."

Thus on the basis' of above definitions we can say that Stock Exchange centre is an organised market wherein shares, debentures; " bonds and government securities are bought and sold as per rules and regulations prevailing in the country.

**Salient Features of Stock Exchange**

The following arc the salient features of Stock Exchange :

1. Stock Exchange is an organised-market From where industries, corporations etc. get the capital.
2. All sorts of securities are bought and sold in Stock Exchange centres.
3. All the functions of Stock Exchange are carried on as per the rules, sub-rules included in the constitution. .
4. An individual person can become the member of a Stock Exchange. Firm/Company is not allowed to seek membership.
5. Purchase and sale of securities in the Stock Exchange are carried on by the registered brokers, sub-brokers etc.
6. Securities are bought and sold in the market after listing of securities-in the stock exchange centres.
7. Transactions of securities are clone either in cash or as promised in the market.
8. The regulation and control of stock exchange cetnres are under the securities contract (Regulation) Act of 1956.
9. Securities are bought and sold nationally and internationally in stock exchange centres.

**Advantages of Stock Exchange**

Stock Exchanges are measurement of economic prosperity in the country. Collection of savings from the public, putting these savings into productive channels, to make available capital for industrial sector and to decide the direction of industrial development are some of the advantages of stock exchange. The advantages of stock exchange can be classified into following categories

1. Advantages to investors
2. Advantages to companies
3. Advantages to country

These advantages ate discussed as given under :

I. Advantages to Investors

The following advantages to investors- from. stock exchange are discussed :

1. Safe Investment : Stock exchanges encourage investors to invest in secured securities because they protect the interest of investors. There is minimum risk in such investment because purchase and sale of listed securities are made in stock exchange. The possibility of deceitful activities minimized because all the transactions are carried on as per the rules and regulations. The prices and information regarding securities are published from time to time in stock exchange which also benefit investors.
2. Availability of place for investment : Stock exchange provide the place for investment to investors. Brokers, sub-brokers, jobbers, clerks and other member provide guidance to investors. All the services are made available on the same place to the investors in stock exchange.
3. Provide regular market : Subsidiary market is made available by stock exchange to investors. Investors can select the securities in these markets and can invest their savings. Investors can invest in new issues as well as in .old issues. Thus both the alternatives are opened by the stock exchange for the investors.
4. Implementation of investment's guideline : Stock exchange pay special attention on the safety and protection of investors' interest. Stock exchange publish the literature regarding the market value, report, opinion-of experts;- risk-elements listing of securities, fluctuations in the prices etc. Stock exchanges have opened public relation office which provides proper guidance and advice to the investors.
5. Liquidity of investment : The stock exchange provide the opportunity to investors to maintain the liquidity of investments as at any time investors can make purchase and sale of securities in

the market. There is no difficulty in purchase and sale of listed securities in stock exchange and from such information purchase and sale of securities, are made easier. Thus stock exchange provide liquidity in investment.

6. Transferability of securities : Stock exchange provide transferability of securities to the investors. Investors as per their requirements can do purchase and sale their securities and their transfer can easily be done in stock exchange and the investors can get the loan from the bank.

II. Advantages to Companies

Companies have the following advantages from the stock exchange :

1. Listing of securities : Securities of companies are listed in stock exchange centres and listing of securities increases the credit of the company. Market price of the securities increases and. investors' confidence in the company is enhanced and the value of securities does not fluctuate.
2. Provide secondary market : Stock market provide the facilities of secondary market. Old securities arc sold and securities giving more profit are purchased. Companies get the facilities to get the loan from the secondary market.
3. No fluctuations in the .prices of securities : Stock exchanges benefit companies that the securities prices do not fluctuate. The prices of securities do not fluctuate so that the investors are encouraged to invest more.

III. Advantages to Country

Country has the following advantages from the stock exchange centres

1. Balanced growth : Stock exchange lead to balanced growth of the country. Investors arc encouraged to avail the Opportunity of investing in profitable industries and investors withdraw their investment from non-profitable industries and make profitable investment. Thus the stock exchange plays an important role in the development of the country.
2. Crintintrans-capital formation –The process of capital formation continues with the help of stock exchange. Stock exchange collect small savings and these savings are invested in securities. It increases the capital formation. Investors get dividend and this is reinvested. The process continues.
3. Attraction of foreign capital : Foreign capital is attracted in stock exchange centres. Non-resident Indians can also purchase securities because stock exchange centres provide all information and facilities for investment.
4. Facilities for raising of capital to government : Government can raise capital from stock exchange centres to accomplish its development plans. Government issues debentures, bonds and other securities for raising finance from the market: Stock exchange centres help the government in raising the capital.
5. Facilitates import and export payments : Imports and exports in a country also require finance for finalising the transactions. Stock exchange centres, help in getting the finance for exports and imports.
6. Provide finance for industrial sectors : Finance on large scale is made available to industrial sector through stock exchange centres. Short term, medium term and long term financial requirements are easily met by stock exchange centres for industrial development. Availability of finance helps in completing the various projects and the industrial base of the country is made strong.

**Demerits of Stock Exchange**

There are several drawbacks or demerits of stock exchange as discussed below :

1. Encourage speculative activities: Stock exchange encourage speculative activities. Forward transactions, borrowed transactions and transfer of cost etc. lead to speculative activities because the amount of difference is not deposited by the parties.

2. Fluctuation in price of securities: Price of securities fluctuates which leads to instability and investment is adversely affected.
3. Unskilled and non-experienced employees : The most important defect of stock exchange is that persons working in these centres are inexperienced and unskilled. They do not know the rules of stock exchange centres. Brokers and authorised persons can finalise transactions in the stock exchange. The inexperienced clerks adversely affect the benefits of investors.
4. Liberal attitude : Rules and sub-rules in stock exchange are strict but they arc not effectively implemented. Board of management also does not use the rights with strictness and On account of such unfair transactions take place.
5. Hurdles in development : Deceitful behaviour, speculative transactions, transactions without entries are carried on account of such activities. the working of stock exchange is seen with doubt and investors do not ready to invest their money. It adversely affects the adequate supply of finance from stock exchange.
6. Affecting companies' credit efficiency : The market price of securities of different companies is published from time to time. If the company wants to raise capital from the market and the market, price is high then there is no problem, contrary to it when the price in the market is low then the company will face the problem in raising the capital.

**Functions and Role of Stock Exchange**
Stock Exchange is the Barometer of the country's economy. These centres attract the country's capital towards industries. Professor W.T. King has rightly pointed out, "In the absence of these Stock Exchange the savings or public cannot be utilised for the economic progress and productive efficiency and they can easily be used as a compensatory measure which. is a source and measure of economic progress. and productive efficiency." Stock Exchanges are considered index of economic changes. They reveal that in winch direction the country is moving.

**Functions of Stock Exchange- :**
Stock Exchange discharge three, important functions in the growth of capital formation as given under :
1. Nexus between savings and Investment
2. Market Place
3. Continuous Price Formation.

**Nexus between Savings and Investment**
There is close relationship between the saving and investments of the community. Stock exchanges Mobilise the savings of the community for investment in productive uses so that the community can get good return, appreciation of capital and so on. Stock exchanges render the services by arranging preliminary distribution of new issues of capital, offered through prospects and sale of existing securities in a systematic manner. Members of the stock exchanges also assist in the floatation of new issues by acting as brokers and under writers. Stock companies also provide a forum for trading in right shares of companies already listed so that a new class of investors.

**Market Place**
Another function of stock markets/exchanges is that they provide a market place for the purchase and sate of securities. They also provide free transferability through several successive stages from the original subscriber. The sale and purchase is centralized with a multiplying of buyers and sellers at any point of time.

**Continuous Price Formation**
Another function closely related to market place, 'discharged by the stock exchanges is the process of continuous price formation. A large' number of people are operating simultaneously in the market. leading to . the emergence of a large number of buyers and sellers at any point of tithe which brings changes in the level of security prices causing wide Swings in prices. Stock exchanges act as a

barometer of the state of health of the nations economy. An investor can always have his eyes turned towards the exchanges keeping the value of investments of plan his personal-requirements.

The functions or stock exchange with reference to investors, companies, society and nations can be studied as given under :

**I. For Investors :**

Stock Exchanges work in. the interest of investors as given under

1. To provide liquidity in securities : Stock Exchange provide a well developed market to buyers and sellers of securities. Security-holders can easily sell his securities and can. convert in liquid and new securities can be purchased.
2. Selection of securities : Stock Exchange act as guide to investor"; in which securities they should invest their money.
3. Provide information of listing of securities Stock Exchange also provide information to the investors Whether securities have been listed or the securities are unlisted securities. The listed securities can be presented in any stock exchange where they can be purchased and. sold. Such securities can also be mortgaged in the banks and credit can be borrowed by the holders of such securities. The actual prices of securities arc known to. the investors through stock exchange when the securities are listed.
4. Reduce in risk : Stock Exchange provide the information to investors regarding the securities. Investors are saved from those securities wherein more risk is involved. The risk in case of listed securities is less than those of unlisted securities. The listed securities are based on the economic viability of the companies.

**II. For Companies :**

Corporate sector has developed on account of the evolution and growth of Stock Exchange in our country. Large companies of such stock companies; have. been formulated, developed and expanded in recent years. The following functions are; performed by stock exchange for companies

1. Increasing credit of companies : Facility of listing is provided to companies by Sleek Exchange: It leads .to. increase the confidence of investors in such companies. The credit and prestige of companies are enhanced by stock exchange in the market and the companies can get the long term credit from the capital market.
2. Increases mobility of capital: Listed securities are bought and sold in stock exchange which enables companies to raise more capital in the market. It increases the mobility of capital in the market.
3. Increases in transferability: Stock exchange increases the transferability of securities by which companies are assisted to raise long term finance. More the marketability of securities more will be the transferability in the market.
4. Helps n price determination of securities: The market price of companies' securities depends upon the declared profit volume after taking into consideration of economic stability, rate of dividend, capacity to earn income and taxes paid, stock exchange studies all these factors while determining the price by which companies are benefited.
5. Controls speculative activities : Better stock exchange controls the fluctuation in the price of securities. Prices of securities are stabilized which will control the speculative activities. A balance is maintained in the purchase and selling of securities as these activities are carried on as per rules and traditions in the stock exchange centres and thereby speculative activities are controlled.

III. Functions for society and Nation:

Stock Exchange play an important role for the society and the country. They encourage savings in society so that industrial; investments are attracted. It leads to accumulated adequate capital with institutional; investors in the country which is helpful in capital formation and consequently capital formulation accelerate the rate of economic growth. It provides a strong base to the economic, new industries come up and the continuity in the economy is maintained.

Stock Exchange centres are developed as a secondary markets of securities. The flow of capital form securities of centres, state, local self governments, private companies and financial institutions towards industries and from industries to public is made possible in such markets. Such flow of capital encourages capital formation and contributors to the development fo the country.

**Listing of Securities**

When a stock Exchange entre recognized the shares and debentures of company which can be bought and sold in the market. According to securities Contract (Regulation) Act of 1956 the listed securities are only bought and sold in recognized Stock Exchange cetnres. Hence the listing of securities is a must with Stock Exchange centeres to deal in securities. Although listing of securities is voluntary but the company has to describe in its prospectus that the company has applied for listing or not.

Thus listing of securities on a recognized stock Exchange means that they are admitted on a recognized stock Exchange which provides a forum for purchase and sale of securities.

**Central Listing Authority (CLA):**

This authority is being set up with representatives of regional exchanges. The CLA has two primary roles-laying down standard listing processes and carrying out the due-diligence of a company to be listed. This authority has the responsibility to update the listing norms depending upon the internal and external environmental developments

In order to restore confidence of the investors in the stock markets the SEBI has also been working out new Listing modalities, making the listing of unscrupulous companies difficult. Uniform criteria for listing for companies in any of the stock exchanges, would prevent unscrupulous promoters from entering the capital market through smaller exchanges.

**Listing is obligators**

Under section 73 of the companies Act, 1956, every company floating shares or debentures in the public for subscription by issue of a prospectus has to first make an application to one or more recognized stock exchanges for their listing.

Listing is not obligatory for companies not making public issue of shares and debentures. Unlisted companies are subjected to promoters' quota with a lock-in stipulation. As per the Disclosure and Investor Protection (DIP) guidelines published in July 1997, the SEBI has reduced the promoters' contribution subject to lock-in in case of offers for sale of securities of unlisted companies to 20 per cent from the prevailing 25 per cent.

From March 2001, the SEBI has allowed all companies to. issue debt securities to the Public without listing equity. Before this provision this facility was available only to infrastructure companies and municipal corporations. But this has been allowed only for investment grade securities. For an issue above Rs. 100 crore, investment grade rating from two rating agencies will be required. The promoter will have to bring in 20 per cent of the equity requirements of the project for which the debts are being raised.

**Consequences of Non-listing :** Those companies applied for granted permission before the expiry of ten weeks from the date of closure of subscription list, then the following consequences will emerge :

1. Any allocation of shares/debentures on an application shall be void;
2. Submit required books, documents and papers and disclose any other information which the stock exchange ask for;
3. Send to all shareholders the notices of Annual General Meetings, Annual Report, etc.; and
4. Place its securities with the public.

**Pre-requisites for qualifying for listing :** The following are the minimum essential requirements which a company has to comply with before its securities can qualify for listing on a recognised Stock Exchange :

1. **Minimum issued, capital and minimum public offer :** The minimum issued capital of company must be Rs. 3 crore of which at least Rs. 1.80 crore in face value must be offered to the-general
2. **Minimum number of shareholders :** There must be at least five public shareholders for every Rs:1 lakh of fresh public issue of capital and ten public-shareholders for every Rs. 1 lakh of offer for sale of the existing capital. The rules are different in case of investment companies.
3. **Payment of interest on excess application money:** The companies are obliged to pay interest on excess application money at the rates ranging from 4 per cent to 15 per cent depending on the delay beyond 10 weeks from the date of closure of the subscription list.
4. **Listing on more than one exchange and on regional exchanges :** Every company with paid up capital of more than Rs. 5 crore has to get itself listed on more than one stock exchange, including compulsory listing on regional stock exchange.
5. **Compulsory provisions in the Articles of Association**: A company applying for listing on -a recognised stock exchange must satisfy the stock exchange that in addition to other matters, its Articles of Association provide for the following :
   - that a company shall-Use 'a common form of transfer,
   - that the fully paideshates will be free from all lien,
   - in the case of partly paid shares, the company's lien, if any, will be restricted to money called or payable at a fixed time in respect of such shares,
   - that any amount paid up in advance of calls on any share may carry interest but shall not entitle the holder of the share to participate in respect thereof, in dividend subsequently declared,
   - there will lie no forfeiture of unclaimed-dividends-before-the-claim becomes barred by law, and
   - that option or right to call off shares shall not be given to any person except with the sanction of the company in general meeting.
6. **Minimum public offer for subscription** At least twenty five percent of each class or kind of securities issued by the company is to be offered to the public for subscription through advertisement in newspapers for a period of not less than two days and that applications received in pursuance of such offer are to be allotted fairly and unconditionally.
7. **Cost of public issue of capital :** The new companies will be considered for listing and the listing of old companies will continue only if they adhere to the ceiling in expenditure of public. issues.
8. **Undertaking regarding restriction on transfer of shares from promoters quota :** The auditors or practicing company secretary of the company applying for listing have to certify that the share certificates have been stamped so that snares from promoter's quota cannot be sold/hypothecated/transferred for a period of three years.
9. **Corporate governance must for listing :** New companies applying for listing have to enter into an agreement with the stock exchange undertaking to comply with corporate governance rules. All companies already listed on the stock exchanges will have to adhere to the new code if they want to remain listed on exchanges.

**Other Conditions and-Undertakings for Listing**

A company applying for listing has to satisfy the following conditions prior to listing :

1. The letters of allotment and letters of regret will be issued simultaneously at the same time.
2. To issue receipts for all securities deposited with it whether for registration, sub-division, exchange or for other purposes; and not to charge any fee for these services.
3. To issue consolidation and renewal certificates in denominations of the market unit of trading to -split certificates, letters of allotment, letter's of rights and transfer, renewal, consolidation,

and split receipts into smaller units, to split call notices, issue duplicates thereof 'and not require, any discharge on call receipts and to accept the discharge, of members of stock exchange on split, consolidation-and renewal receipts as good and sufficient without insisting on the discharge of the registered holders.

4. When documents arc lodged for sub-division or, consolidation for renewal through the clearing house of the exchange to accept the discharge of an official of; the stock exchange clearing house on the company's split receipts and consolidation receipts wad renewal receipts, as good and sufficient discharge without insisting on the 6h:charge. of the registered holders and to verify when the company is unable to issue certificates Of split receipt or consolidation receipts or renewal receipts immediately on lodgment whether the discharge of the registered holders.
5. On production of the necessary documents by shareholders or by members of the exchange, to make on transfers in endorsement to the effect that the power of attorney or probate or letters of administration or death certificate or certificate.. of the 'controller of estate duty.
6. To issue certificates in respect of shares or-debentures lodged for transfer within a period of. one month of the date of lodgement of transfer and to issue balance certificates within the same period where the transfer is accompanied by a larger certificate.
7. To advise the stock exchange of the date of the board meeting at which the declaration or recommendation of a dividend or the issue of right or bonus share -Will be considered.
8. To recommend or declare all dividends and cash bonuses at least five days before the commencement of the closure of its transfer books or the record date fixed for the purpose and to advise the stock exchange in writing of all dividends or cash bonuses recommended or declared immediately after a meeting of the Board of the Company has been held to finalise the same.
9. To notify the stock exchange of any material change in the general character or nature of the company's business.
10. To notify Ile stock exchange of any change in the company's directorate by death, resignation, removal or Otherwise, of managing director, managing agent or secretaries and treasurers and of auditors appointed to audit the books and accounts of the company.
11. To forward to. the stock exchange copies of statutory and annual reports and audited accounts as soon as issued, including director's report.
12. To forward to the stock exchange copies of all other notices and circulars sent to the -shareholders including proceedings of ordinary and extra ,ordinary general meetings of the company and to file with the stock exchange certified copies of resolutions of the company as soon as such resolutions .become effective.
13. To notify the stock exchange prior to. Intimating the shareholders of any new issue of securities whether by way of right, privilege, bonus or other voice and the manner in which it is proposed to 'offer or allot the same.
14. To notify the stock exchange of any other alteration of capital including calls.
15. To close the transfer books only for the purpose of declaration Of dividend or issue of rights or bonus shares or for. Such lathe: purposes as the stock exchange may agree and-after due notice and sanction.
16. To grant to shareholders the right of renunciation in all cases of issue of rights, privileges and benefits and to, allow them reasonable time for exercise of such right.

**New Entry Norms for Unlisted Companies**

The SEBI approved the draft compendium of SEB1's Disclosure and Investor Protection Guidelines on August 12, 1997 which lays down the following tightened entry norms for unlisted companies :

1. Unlisted companies should have said dividend in immediately preceding three years before public issue.
2. An unlisted company can freely price its securities provided if has shown net profits in the immediately preceding three years subject to its fulfilling the existing disclosure requirements.

3. A listed company Would be required to meet the entry norms only if the post issue net Worth becomes more than five times the pre-issue net worth.
4. Companies would be required to make their 'partly paid-up shares full); paid-up or forfeit the same, before making a public/rights issue.
5. Prior to these Modifications, promoters' contribution for public issues by unlisted as well as listed companies was specified as 25 per cent for issue size up, to Rs. 100 crore and 20 per cent for issue size above Rs.. 100 crore.
6. Only such securities can be offered for promoters contribution for which a specific written consent has been obtained from the shareholders for lock-in.
7. Appointment of a 'Registrar Loan Issue for rights issue is now mandatory.
8. A provision has been made regarding disclosure of the shareholders of the promoters Whose name figure in the paragraph on Promoters and their background'.

**Withdrawal of Listing**

A recognised stock exchange may suspend/withdraw admission to dealings in the securities of a company or body corporate either for a breach of or non-compliance with for any reason the opinion of the stock exchange justifies such action.

**Documents to be submitted for Listing**

A public company desirous of getting its securities listed on a recognised stock exchange has to apply for the purpose to the stock exchange and forward along with its application the following documents are required :

1. Memorandum and Articles of Association and in case of a debenture issue, a copy of the trust deed.
2. Copies of all prospectus issued by the company.
3. Copies of offer's for sale and circulars offering any securities for subscription or sale during the last five years.
4. Copies of balance sheets and audited accounts for the last &tie years.
5. A statement relating to dividends and cash bonuses paid during the last 10 years.
6. Certified copies of agreements relating to vendors, promoters, underwriters and sub-underwriters, brokers and sub-brokers.
7. Certified copies of agreements with managing agents, secretaries, treasurers, selling agents, managing. directors, general manager, sales manager, manager or secretary.
8. Certified copy of every letter, report, balance sheet, valuation contract, court order or other document relating to any prospectus, offer for sale, circular or advertisement offering securities for subscripted or sale during the last five years.
9. A statement containing particulars of the dates of and parties to all material contracts, agreements, concessions and similar other document's.
10. A, brief history of the company since its incorporation.
11. Particulars of shares and debentures issued:
12. A statement containing particulars of any commission, brokerage;. discount or other-special terms including an option for the issue of any kind of the securities granted to any person.
13. Certified copies of letters of consent of the controller of capital issue.
14. Particulars of share forfeited.

**Public Issues**

Public issues can be floated in any of the following ways :

1. Public Issue through prospectus
2. Through offer for sale
3. Through placement of securities—private placement and stock exchange placing.
4. Rights issue

5. Issue of bonus shares
6. Book building
7. Stock option

**Public Issue through Prospectus**
This is the most common method of issue of securities by companies. Under this method, the company issues a prospectus which is an invitation for subscription by the investing public. It is a direct Offer by the issuing company to the general public to subscribe to the securities of the company at a stated price. The shares of a new company are issued at the face value while the shares of an old company can be issued ai a premium also. Public issue through prospectus is underwritten to safeguard against an unsatisfactory response from the public.
Prospectus of a company comprises of
1. Company's name and address of its registered office.
2. Names and addresses of the company's promoters, manager, managing director, directors, company secretary, legal advisor, auditors, bankers, brokers etc.
3. The date of opening and closing of subscription list.
4. Contents of Articles or any contract relating to terms and conditions of appointment of managing director or manager.
5. The names and addresses of underwriters, the amount underwritten and the underwriting commission.
6. Material details regarding the project — location,. -plant 'and - machinery, technology, collaboration, performance 'guarantee, infrastructure facilities etc.;
7. Nature of products, marketing set-up, export potentials and obligations;
8. Past performance and future prospects.
9. Management's .perception regarding risk factor.
10. Credit rating Obtained from
11. A statement that the company will make an application to specified stock exchanges for listing its securities.

The directors, promoters and experts can be held liable, both under the civil law and under the criminal law, for any misrepresentation in the prospectus or any material omission.

**Advantages**
The following are the advantages of public issue through prospectus :
1. Entire issue process in terms of the amount of issue, the type and mix of issue, terms of issue, etc. appears transparent to the public the concerned authorities.
2. It gives a wide publicity for the company and its issue.
3. A major portion of the issue is allotted among the applicants on non-discriminatory basis.
4. Issue gets widely distributed.
5. Artificial restriction of availability of shares in the market is avoided.

**Limitations**
The following are the drawbacks of public issue through prospectus :
1. Floating Costs—Underwriting expenses, brokerage etc.
2. Administrative costs — Printing of prospectus,- documents,- related administration costs, postage and batik charges etc.
3. Publicity. .costs.
4. Legal costs—Stamp duty, registration fee, listing fee, mortgage dcccl, registration fee, expenses relating to filing of documents etc.

**Pricing of Public Issue**
Several factors affect the pricing of securities specially shares of a company namely time factor, marketing factor, Government policies, interest rate. and provisions of Company Act, 1956. While pricing of shares a company has to take into-consideration these factors. There are different ways of price determination of shares in case of new company and old company.

**Pricing of New Issue :** When a new company raises capital by floating shares in the market then it cannot, issue shares on less than their par values. The par value for 'equity share is Rs. 1.0 while for the preference share it is Rs. 100. Most of the Indian companies take into consideration these two par values while pricing shares.

**Pricing of Existing Company Issue :** Those companies which have already been established can issue their shares On discount but they have to comply the conditions given under Section 79 of the Company Act as follows :

1. The proposal of issuing shares at discount should be passed in the general assembly of the company and the Company Law Board should give the consent.
2. The maximum discount rate should be mentioned in the proposal' but this rate must not exceed 10 per cent or more with the prior permission from the Company Law Board.
3. Company can be allowed after one year it has started its business for type of discount-issue.
4. The discount share can be issued by the company within 2 months of the permission given by the Company Law Board.
5. Those shares which have been issued, the same type of shares can be issued as discount shares.
6. The statement of discount. of issued shares should be prepared.

If the market price of shares is high then it is understood that the company has strong financial position., The company has adequate reserves. The company can issue shares on premium. There is no need of passing proposal from Company Law Board. The premium amount is deposited in Security Premium Account. The amount can be used for the following activities under Section 78 of Company Act, 1956 :

1. Issue of bonus shares.
2. To meet initial expenses of the company.
3. 3.To abolish issue expenses, commission, rebate of the company.
4. To make arrangement for commission for the redemption of payment of preference shares.

The premium pricing of shares of a company sleepers on several factors namely earning capacity, market conditions, market value of shares etc.

Company also issues rights share. The existing shareholders get the-right of pre-emption and the right value is also included in such shares . in the market. The Right of Pre-emption has been one away with in 1992. All have, right to take these shares. Such shares should be issued on the market price.

**Marketing of Issue**
When the securities issued in. the market are easily bought then we can say that there is marketability of securities. Contrary to it the company will face the problem in raising capital and all the plans of the company will be adversely affected. The marketability of a company can be divided into two categories as given under :

**I. First Issue of Securities of Newly Promoted Companies**
When a company is newly sponsored and it issues securities for the first time, it is affected by the following factors

1. Low par value : There is an indirect relationship between the low par value of a security and the number of investors. Lower the par value of a security more will be the number of investors investing in such security and vice versa.

2. Income:- Investors are more interested in those securities which give them more income. Among such securities preference shares and debentures are preferred. If the rate of return on shares is high more will be the purchases of the shares.
3. Safety : Each investor wants safety in the investment. If a new sponsored company is closely associated with Industrial House the investors will blindly invest and more purchases--of the securities will be there.
4. Time of Issue: The time element also affects the investment in securities of a new company. More will be the investment in those securities where the prevailing rates of interest is high, favourable business conditions, prosperity, favourable fiscal policy, price stability etc. exist. Contrary to it, there will be less 'investment in securities when the unfavourable conditions are prevailing.
5. Goodwill of Management : If the managers of a newly set up company are sincere, honest and well known the marketing of securities will be more and contrary to it. marketing of the securities will be less.
6. Size and Type of issue : The size and type of securities also affect the marketing of securities floated by a new company. If the size is large there will be doubt about its marketability. One type of securities will be bought less. Thus smaller the size and diversified nature of securities will have high marketability in the market.
7. Exemption from Tax : The marketing of securities will be large when there is tax concessions in their investment. UTI schemes, infrastructure bonds issued by 100 Bank and IDBI are preferred more because of exemption from tax under Section 88 of Intone Tax Act.
8. Services from Under niters : When the services of underwriting, brokers, commission agents are taken the sale of the securities increase while less the services from under Writers less will be the sale of these securities.

**II. Public Issue of Securities by Existing Companies**

Existing companies also collect capital from the public. The public issues of such companies are affected by several factors which are discussed below :

1. Dividend Rate : The declare dividend rate on any security/share/debenture also affects the public issue of an existing company. If higher the dividend rate higher will be the marketability of securities and vice versa. The declared dividend rates in the past also affect the marketing of securities.
2. Regularity in Payment of Dividend : The new issues will be easily sold when the company has been paying dividend regularly. Contrary to it less investors will be attracted to purchase such securities.
3. Objectives of Receipt of Capital : What are the objectives of raising capital by a company? The success of capital issues depends upon the objectives. Some of the objectives are to set up new plant, expansion of the company, increase in the capital of the company. If the capital is raised for risk ful ventures less marketing of issues will take place.
4. Provide option : Companies also provide options while issuing securities in the market. More the options more will be the marketing of issues. For example, facility to convert preference shares into equity shares.

In the secondary market, the upirends continued in 2006-07 with BSE sensex and NSE NIFTY indices. closing above 14000 and 4000 marks for the first time on January 3, 2007. There was a large in flows from Foreign Institutional Investors (Fits) and large participation of domestic investors. During 2006 sensex and Nifty indices rose. by 46.7 and 39s percent respectively. There was impressive growth rate in profitability of Indian Corporate, overall higher growth in the economy and other global factors such as continuation of relatively soft interest rates and fall in crude oil prices in international markets.

Amongst the NSE indices, both Nifty and Nifty Junior delivered strong positive returns appreciating by 39.8 percent and 28.2 percent during 2006.

**Measures undertaken in the Secondary Market**

Several measures were undertaken by the Government of India during 2006-07 as given under :

1. The stock Exchanges were advised to update the applicable value of Risk (VAR) margin at least 5 times in a day by taking the closing price of the previous day at the start of trading and the prices at 11 AM, 12.30 PM, 2 PM and at the end of the trading session.
2. The reporting shall be made for all traders in listed debt securities issued by all institutions - banks, Public sector undertakings, municipal corporations, corporate bodies and companies. SEBI and RBI have set up on internal working Group to implement the Budget2006-.07. A single, unified exchange traded market for corporate bonds has been announced on the recommendations of R.H. Patil Committee Report on corporate bonds and securitization.
3. PAN has been made mandatory with effect from January 1, 2007 in order to strengthen the 'Know your client' Norms and to have sound audit trail of the transactions in the securities market.
4. The limits for foreign investment in stock exchanges depositories and clearing corporations have been specified as given under:
   - Foreign investment upto 49 percent with a separate Foreign Direct Investment Cap of 26 percent and Cap of 23 percent on FIIs investment.
   - FDI will be allowed with specific prior approval of FIPB
   - FIIs will be allowed only through purchases in the Secondary market.
   - FIIs shall not seek and will not get representation on the Board of Directors and
   - No foreign investor will hold more than 5 percent of the equity in these companies.
5. Simplification of application process of FIN and new categories of investment-Insurance and new insurance companies, foreign central banks, investment managers international organisation's have been included under His.
6. The cumulative Debt Investment limits have been raised from GS$ 1:75 billion to US $2 billion for Eli by the Government of India. The limit of Flis investment on central state Government Securities has been further enhanced by RBI to US $3.2 billion by March, 31, 2007.
7. Initial Issue Expenses and Dividend Distribution Procedure for Mutual Funds were rationalized.
8. Mutual Funds were permitted to introduce Gold Exchange Traded Funds as proposed in the budget 2005-06.
9. The aggregate ceiling for the Mutual Funds industry to invest inADRs/GDRs issued by Indian Companies has been raised from US $1 billion to US $3 billion.
10. Foreign institutional investors have been allowed to invest in security receipts.
11. On the recommendation of SS Tarapore (Fuller capital Account Convertibility) the RBI has appointed a task force to identify the anomalies in the present regulatory framework for current and capital accounts and the rectification should be. undertaken within a period of three months.

Unit – 4

**INDUSTRIAL FINANCIAL INSTITUTION**

The sources of industrial finance were extremely inadequate to meet the growing demands of finance Of the existing industries, not to speak of Many new industries which were coming up, the Government of India set up in 1948 the Industrial Finance Corporation of India to grant loans and advances to industrial concern-s, to -subscribe to the debentures floated by them and to underwrite new issues of stocks and debentures of industrial concerns. In 1955, the Industrial Credit and Investment Corporation of India (I.C.I.C.I.) was set up to promote new industries, expand and modernize existing ones, to encourage the inflow and participation of foreign capital in Indian private enterprises and to furnish technical and managerial aid. The Government has also set up the Industrial Development Bank of India (I.D.B.I.) and the Unit Trust of India (U.T.I.) as important sources of industrial finance. The Government set up the National Industrial Development Corporation (N.I.D.C.) and the Refinance Corporation for Industry also to assist industrial financing.

**1. Industrial Finance Corporation of India (IFCI)**

The IFCI was the first development bank established in India in 1948. It was converted into a Public limited company with effect from 1 July 1993. Its main objective is to make medium and long term credit to industrial concerns in the private, public, joint and cooperative sectors in India. It is a subsidiary of the IDBl which holds 50 per cent of its share capital-and the remaining 50 per cent is held by banks, insurance companies and cooperative banks. It augments its resources by borrowing from the Government of India, RBI, IDBI, UTI, LIC and by issuing its :Bonds and debentures in the market arid by borrowing in foreign currency from the World Bank and other foreign organizations.

**Its Functions**

The IFCI performs the dual function of a financier and promoter. These functions reveal its multifaceted activities.

a. It sanctions loans and advances to industrial units and also subscribes to the debentures issued by them, provided they-are repayable within 25 years front the date of issue.
b. It guarantees loans floated by the industrial concerns in the open market, provided they are repayable within 25 years.
c. It underwrites the issue of stocks, shares, bonds and debentures floated by the industrial concerns.
d. It can subscribe units.
e. It can sanction loans and advances to public limited companies and cooperative Societies, but 'not to a private limited company or a partnership firm.
f. It can grant only medium-term and long-term credit assistance to industrial units:

**2. Industrial Development Bank of India (I.D.B.I.)**

The Industrial Development Bank of India (MBA.) was premier tetra-lending institution devoted exclusively to financing the requirements of industries in India. The I.D.B.I was set up in July, 1964, as a wholly owned subsidiary or the Reserve Bank of India. With effect from February 16, 1976 it was delinked from the RBI and made an autonomous corporation fully owned by the Central Government.

**Its Functions**

The IDBI is an apex institution hi the sphere of development banking in India which performs financing, coordination and promotional functions. It renders assistance to small, medium and large scale industries in public, private, joint and cooperative sectors.

a. Schemes of Direct Assistance: It extends direct assistance to industry under its Project Finance Scheme and the Technical Development Fund Scheme. The Project Finance Scheme also covers assistance under the Textile Modernizations Fund, Venture Capital Fund, Technology Up gradation Energy Audit Subsidy and Equipment Finance for Energy Conservation Schemes.

b. Refinance of Industrial Loans: It renders indirect assistance by refinancing the term loans extended by SFCs, SIDCs, commercial/cooperative banks and RRBs to industrial concerns.
c. Bills Rediscounting Scheme : This scheme is meant to help the use of indigenous machinery by industrial concerns. Under this scheme, the purchaser draws the bill in favor of the manufacturer of machinery who discounts it with his banker who in turn gets it rediscounted from the IDBI. This facility is provided mainly to sugar, jute, cotton textiles, cement and engineering industries.
d. Seed Capital Scheme: Under this scheme, financial assistance is available to new entrepreneurs for meeting the gap in promoter's contribution as well as equity where no issue of public shares is done,
e. Assistance to Leasing Companies: Financial assistance is also sanctioned to leasing companies for refinancing their hire-purchase and leasing schemes.
f. Resources Support to Other Institutions: The IDBI provides resource Support to other financial institutions by subscribing to their shares and bonds/debentures such as that are issued by IFCI, IC ICI, SFCs, SIDCs, NS1C, TCOs etc.
g. Merchant Banking: It carries out merchant banking activities and helps industry in raising capital from the market and renders advice,
h. Commercial Banking: It has set up the 10131 Bank Ltd. since 1995 as a private commercial bank.

**3. Industrial Credit and Investment Corporation of India (ICICI)**

The ICICI was established in January 1955 as a public limited company. It is a private sector development bank in India. The World Bank played a key role in its formation. Its authorized capital is Its 100 crones. About 11 percent of its share capital is held by the World Bank and other foreign financial institutions and the remaining by Indian Banks, M. GIC, LIC etc. During 1990-91 for the first time, ICICI entered the, capital market with a public issue and raised Rs. 100 crores.

**Its Functions**

The ICICI renders both financial and promotional assistances private, joint, public and co-operative sector industrial concerns.

**Financial Assistance:** The ICICI provides financial assistance of the following types:

- Project Finance: Assistance for project finance is by way of rupee and foreign currency ions, underwriting and direct subscriptions to shares and debentures and guarantees.
- Financial Services: Assistance by way of financial services to industry includes assistance under schemes of deferred credit since 1982-83, equipment leasing since 1983-84, venture capital during 1986-87 to 1987-88, installments sale since 1988-89 and asset credit facility since 1989-90,
- Merchant Banking: The ICICI also renders merchant banking services.
- Commercial Banking: It has set up the ICICI Banking Corporation as a commercial bank since 1994.

**Its Working**

Financial assistance sanctioned and disbursed by the ICICI during 1999-2000 amounted to Rs. 44,479 crores and Rs, 25,836 crores respectively. Of the total disbursed amount, rupee loans, foreign currency loans and guarantees amounted to Rs. 17,597 crores; underwriting and direct subscriptions Rs. 5,248 crores; and others Rs, 2,991 crores. The ICICI is required to achieve 8% capital adequacy norm since 1993-94 which it has been maintaining on an average of 10%.

**4. State Financial Corporation’s (SFCs)**

SFCs. are the state-level development banks for the development of small and medium scale industries in 18 States of India. They aim at bringing about balance regional development by wider dispersal of industries, promoting greater investment and generating large employment opportunities. Besides their paid-up capital, SFCs augment their funds by borrowings from the Governments, RBI, IDBL banks and by Way of bonds/debentures, by accepting deposits and sale of investment in shares and debentures of industrial concerns.

**Functions of SFCs**

a. They provide financial assistance to industries by Way of term loans, direct subscription to equity/debentures, discounting of bills exchange and guarantees.
b. They meet the term loan requirements of small and medium 'scale industries for acquisition of fixed assets like land, building machinery and equipment.
c. They provide loans for setting up new industrial units as well as for-expansion and modernization of the existing units.
d. They also promote the development of medium and small scale industries in backward area of the country.
e. Under the Special Capital Scheme, SFCs provide equity type support of up to Rs. 4 lakhs on soft terms to entrepreneurs for bridging the gap in equity or promoter's contribution. Entrepreneurs with viable projects but lacking adequate own funds are assisted under the scheme.
f. SFCs operate a number of schemes on behalf of the IDBI. These include composite loan scheme, schemes for women entrepreneurs, modernization scheme, equipment finance scheme, schemes for hospitals and nursing homes, scheme for ex-servicemen, single window scheme and special capital and seed capital schemes.

5. **The Export Import Bank of India (EXIM Bank) :** Set up in 1982, Exim Bank has diversified its activities from export credit to a source of comprehensive financial packages to enable Indian Companies to enhance their export production capabilities. It decided to provide self liquidating loans in foreign currency for meeting project expenditure relating to import of capital goods, raw material, components, technology as well as local rupee cost of projects. Bank offers foreign currency loans under the new facility at Libor, plus a reasonable spread, based on the Banks cost of foreign currency funds. While the exchange of the rupee has been stable Net Foreign Exchange Earners (NFEE) are in any case protected against exchange risk since the export cash flows give them a natural hedge in the event of rupee depreciation.

**Securities and Exchange -Board of India —SEBI**

The SEBI has been set up under the SEBI Act to (i) protect the interest of the investors in securities and (ii) promote the development of, and regulate the securities market.

The functioning of the in India has the following weaknesses :

1. With long delays
2. Lack of transparency in procedures
3. Vulnerable to Price rigging
4. Insider trading.

In order to overcome these shortcomings and deficiencies and to regulate capital market, the Government of India set up the Securities Exchange Board of India in 1988. In the beginning it was a non-Statutory body but in January 1992 it was made a statutory body.

**Functions of the Board**

The following are the functions of the SEBI :

1. This regulates business in Stock Exchanges and any other securities market.
2. This registers and regulates the working of stock brokers, sub-brokers, share transfer agents,. bankers to an issue, trustees of trust deeds, registrars of an issue, merchant bankers,

underwriters, portfolio managers, investment advisors and other intermediaries -associated with securities markets.
3. This registers and regulates the working of depositories, 'custodians of securities, FIls, credit rating agencies.
4. This registers and regulates. the working of venture capital funds' and collective investment schemes, including mutual funds.
5. This promotes and regulates self-regulatory organisations.
6. This prohibits fraudulent and unfair trade practices relating to securities market.
7. This promotes investors' education and training intermediaries of securities market trading in securities.
8. Prohibiting insider trading
9. This regulates substantial acquisition of shares and takeover of 'companies.
10. Calling for information from, undertaking inspection, conduct in, the enquiries and audits of the stock exchanges, mutual funds, intermediaries and self-regulatory organisations in the securities market; and
11. Levying fees and other charges for carrying out its work.

SEBI has set up its regional offices at Delhi, Kolkata and Chennai.

**Management of SEBI**

The SEBI is managed by the Board comprising of the following members :

1. Chairman
2. Two members from the Ministry of Finance, GOT .
3. One member from the RBI
4. 5 other members comprising of 3 full time members nominate by the Government of India and the SEBI has constituted two member non-statutory Advisory Committee.

Central Government is empowered to control matters of the SEBI.

**Organization OF the SEBI**

In order to have better functioning of the SEBI, it has been divided, into five departments. In each department Executive Director is appointed. He is accountable to the Chairman of the SEBI. The various departments of the SEBI are as ,given below :

1. Primary Market Policy and Investor Grievance and Guidance Department : This department supervises all the matters relating to Primary Market Policy namely, formulation of Primary Market Policies, Merchant Bankers, portfolio services, Investment Advisor, Debenture Trustee, Underwriters, registration and regulation of Self regulatory institutions, to redress the complaints of investors, to guide' them, educate them and registration of the associations.
2. Issue Management and Intermediaries Department : This department is responsible for the prospectus of new capital proposals. To collect information relating to intermediaries, policies; their guidance and their use. This department coordinates between the primary market and intermediaries
3. Secondary Market Polley : Administration and related activities of Stock Exchange Centres are included in this department Registration and regulation of number of Stock Exchange Centres, implementation of the policies of secondary market, management of new investments, internal trade, price fluctuations etc. are under the control. of this department. Collection of data, their tabulation from Stock Exchanges and Publication is done by the department.
4. Secondary Market Exchange Administration Department : This department supervises the administration of some Stock Exchange Centres. These Stock Exchanges are Indore, Maghadh, Hyderabad, Mangalore, Kanpur, Ludhiyana, Bhuvaneshwar, Gauhati and Cochin etc. The inspection work of these Stock Exchanges is also undertaken by the department. It also registers and regulates the sub-broker of non-member intermediaries.
5. Institutional investment, -Merger,. Acquisitions, Research and Publication Department : The department is concerned with the registration, regulation and direction of domestic and,

international institutional investment. Mutual funds in domestic institutional investment, collection Of shares and acquisition, membership of international organization securities commission, international relations etc, with international institutions. Research on Stock Exchange Centre and .Publication of annual report of SEBI are the functions of the department.
6. Legal. Department : This department looks after all the laws in the inspection of General Council.
7. Investigation Department : This department enquires and inspects all the parties of the Stock Exchange Centres.

**Powers of SEBI**

The following powers have been entrusted to the SI-1BI :
1. To protect the interest of investors in the Security Market.
2. have right to ask information, to enquire it and to inspect of all the persons related with Mutual Funds and Stock Exchange Centres.
3. To have right to put restrictions on unfair trade practices in Securities Markets.
4. To stop insiding trade in securities.
5. To have right to determine fee and expenses.
6. To acquire the rights of Stock Exchange Centres.
7. SEBI has powers to issue guiding principles to all the Stock Exchange Centres as given below
   - Functional transparency and protection of investors' interest etc. are published.
   - Relating to the development of financial institutions.
   - Relating to the determination of issue price.
   - Relating to issue of bonus.
   - Relating to preference shares.
   - Relating to financial instruments.
   - Allocation and transfer of shares to promoters.

**Registration of Members of Stock Exchange**

Government of India Stock Brokers and Sub-brokers Rules 1992 under the SEIM Act, the Central Government issued a notification on August 20, 1992, laying rules relating to stock brokers and sub-brokers.

**Definition of Stock Broker :** A stock broker as a member of the stock exchange and the sub-broker as any person who acts on behalf of the stock broker as an agent or otherwise, for assisting the investors in buying, selling or dealing in securities through such brokers.

**Conditions for Grant of Certificate to Stock Brokers :** The rules stipulate that registration with the SEE! is necessary for acting as a broker or a sub-broker the conditions, for grant of a certificate or registration to act as stock broker are :
1. He holds the membership of a Stock Exchange;
2. (b) He shall abide by the rules and regulations and bye-laws of the Stock Exchange of which he is a member;
3. In case Of any change in the status and constitution the broker shall obtain prior permission from the SEBI, to continue trading in securities;
4. He shall-pay the amount of fees for registration; and
5. He shall take adequate steps for redressed of grievance of the investors within one month of the date of receipt of complaint and keep the SEBI informed about the number, nature and other particulars of-the complaints received from such-investors.

**Conditions for Grant of Certificates to Sub-brokers :** The following conditions are essential for grant of certificates to sub-brokers :

1. He is authorised in writing by- a stockbroker, being a member of a stock exchange for affiliating himself in buying, selling or dealing in securities;
2. He shall pay the fees;
3. He shall take adequate steps for the redressal of grievances of the investors, within one month of the date of their receipt of the complaint and keep the SEBI informed about the number, nature and other particulars of the complaints received; and
4. In case of any change in the status and constitution, the sub-broker shall obtain prior permission from the SEBI to trade in securities.

**SEBI : Stock Brokers and Sub-brokers Regulations, 1992**
SEBI has issued regulations to regulate stock brokers and sub-brokers through a notification on October 23, 1992 with the prior approval of the Central Government.

These regulations specify the procedure for registration of stock brokers and sub-brokers.

**Registration of Stock Brokers**
The application for the grant of a certificate has to be made in Form-A through the stock exchange of which he is a member. The application must be forwarded by the exchange, within 30 days to the SEBI. SEBI. may require the applicant to furnish further information or clarification regarding the dealings of the securities and -matters connected. SEBI may also require personal representation.

While considering the application, SEMI takes into account all matters relating to buying and selling or dealing in securities. It also takes into consideration the fact, whether the stock broker is eligible to be admitted as a member of the stock exchange, has the necessary infrastructure like adequate -office space, equipment and manpower to effectively discharged his activities, past experience in securities business and is subjected to any disciplinary proceedings under the rules, regulations and bye-laws of stock exchange with respect to his business as a stock broker involving,, himself or any of his partners, directors or employees. On being granted a certificate in Form D, the stock broker has to abide by the Code of Conduct. The Code of Conduct lays down general rules, duty to the investors and towards dealing with the other stock brokers.

**General Rules**
A stock broker is expected to maintain high standards of integrity, promptitude and fairness in conducting his business. He is expected to exercise due skill, care, and diligence and comply with statutory requirements and not indulge in manipulation and malpractices.

**Duty to the Investor**
A stock broker shall execute orders at the best available market Price and not refuse to deal with small investors. He should promptly inform his clients about the execution or non-execution of an order and-, make payment for sale and delivery of the securities purchased. A contract note should be issued promptly. He is expected to maintain confidentiality about his clients' investments. Stock brokers should not encourage sales or purchases of securities or furnish quotations, information and advice to earn brokerage and commission. Stock brokers are not expected to deal with clients, who are in default with other brokers. Stock brokers should also disclose to the clients as to whether he is acting as a principal or broker and avoid conflicts of interest. Investment advice should not be given unless required on the basis of information given by the client about his financial situation, security, holdings and investment objectives. Stock brokers should render fair, prompt and competent services to their clients.

**Duties towards other Stock Brokers**

A stock broker should cooperate with the other brokers in comparing unmatched transactions, replacing documents declaring bad delivery, protection of client's interest and settlement' of transactions. A. stock broker should not advertise his business and induce through unfair means, clients from other brokers. Finally a stock broker should not neglect or fail or refuse to submit the required returns to the SERI and stock exchange and not make false or misleading statements on any such returns.

**Registration Fees**

Every stock broker shall pay a registration fee of Rs. 5,000/- for each financial year, where the annual turnover does not exceed Rs., 1 crore; where the turnover exceeds Rs. 1. crore during any financial year Rs. 5,000/- plus 1/100 of one per cent of the turnover in excess of Rs. 1 crore for each financial year. After the expiry of five years, from the date of initial registration, he shall pay a sum of Rs. 5000 for a block of five years, commencing from the sixth. financial year after the grant of initial registration to keep his registration in the future.

**General Obligations and Responsibilities**

1. Every stock broker should keep and maintain the. following books of accounts, records and documents :
   - Register of transactions (Sauda Book)
   - Clients ledger
   - General ledger
   - Journals
   - Cash book
   - Bank pass books
   - Documents, register of shares &-securities received and delivered.
   - Members contact book showing details of all the contracts entered by hint with the other members of the same exchange or counterfoils of duplicates or memos of confirmation issued to such other members.
   - Counterfoils or duplicates of contract notes issued to the clients ,
   - Written consent of the clients with respect to the contracts entered, as principals.
   - Margin deposit book
   - Register of accounts of sub-brokers
   - An agreement with the sub-broker specifying the scope of authority and responsibilities of stock brokers and each sub-broker.
2. The stock broker should inform the SERI, the place where' the books of accounts, records and documents arc maintained and kept.
3. Stock brokers should furnish with SEBI after the closure of each accounting period a copy of an audit report, balance sheet and profit and: loss accounts. Such records should be preserved for a period of five years.

**Inspection of Accounts, Records and Documents by SEBI**

Inspection of accounts, records and documents is undertaken by the SEBI to ensure that they are maintained as per the required provisions Of the SEBI Act, Rules and Regulations and Stock Exchange Regulation Act and the Rules. SEBI can also appoint a qualified auditor to investigate into the books of accounts or affairs of the stock broker.

The inspection may be undertaken after giving reasonable notice time or without notice, if the investors or public interest requires. The stock broker has to cooperate by producing all the records and giving access to the premises. SEBI communicates the findings of the inspection and gives the stock broker an opportunity of being heard before any action is taken.

**Default**

A stock broker who fails to comply with any of the conditions of the registration, contravenes any of the provisions of the SEBI Act, rules or regulations, contravenes the provisions of the Stock Exchange Regulation Act or the rules made there under, contravenes the rules, regulations of the stock exchange; is liable to suspension of registration after an enquiry for a specified period of cancellation of the registration

**Registration of Sub-brokers**

An application in the Form B for registration to the EBI should be accompanied by recommendation letter froth a stock broker, with whom he is affiliated along with two references including one from the banker, should be submitted to the stock exchange of which the stock broker with whom he is to be affiliated, is a member. The stock exchange has to verify the information and certify that the applicant is eligible for registration. The stock exchange should forward the application within 30 days in the case of an individual,. The applicant should be21 year's of-age, should not be convicted of fraud or dishonesty and should have passed the 12th standard or an equivalent examination. If the SEBI is satisfied the sub-broker is eligible for registration, a certificate in Form E is made and the stock exchange is informed.

**Fees**

The sub-broker has to pay a fee of Rs. 1 000 for each financial year for an initial period of five years. After the expiry of five years, the sub-broker should pay a fee of Rs. 500 for each financial year, as long as the certificate remains in force.

The sub-broker should abide by the Code of Conduct. He should maintain high standards of integrity, promptitude and fairness in the conduct of investment business and act with clue skill, care and diligence.

**Duty to Investor**

With regard to the investor, the sub-broker should execute orders at the best market price and promptly finalise the transactions. Purchase or sale notes for all transactions entered by him, with his clients, should be issued promptly. Script wise split purchase or sale notes and similarly, bills and receipts showing brokerage separately have to be issued. A sub-broker should not match the purchase and sale orders of his clients. They should be .routed through the member broker with whom the sub-broker is affiliated.

He should not disclose confidential information about his clients. He should not encourage sales or purchases to earn brokerage and commission. He is not expected to deal with defaulting of clients. Sub-brokers should render fair, prompt and competent services to their clients.

**Duties towards Stock Brokers**

A sub-broker should cooperate with his broker in comparing unmatching transactions, replacing documents declared as bad deliveries, protecting clients' interests and settlements of his transactions with his broker. A legal agreement specifying the rights and obligations of the sub-broker and the principal broker should be executed.

**Prohibition of Fraudulent and Unfair Trade Practices**

SEBI has also been empowered to regulate fraudulent and unfair trade practices relating to the securities market with the notification of October 25, 1995. The notification imposed prohibition against market manipulation, misleading statements to induce sale or purchase of securities and unfair practices relating to the securities and laid down procedures for alleged contraventions. These activities which have been notified are discussed as given under:

1. Monitoring of Price Manipulation: A division has been set up within the SERI to monitor unusual movements in prices in coordination with the stock exchange. SPIN has initiated investigation in several cases where market manipulation was suspected. The stock exchanges are to start monitoring the prices of newly listed scrips from first day of trading. Circuit breaker system and other market monitoring restrictions would be applied from the second day of trading. Stock exchanges have agreed to this because of the possible misuse of the 4 days currently available for price formation and stabilization.

In case of newly listed/permitted strips, Where there is abnormal price Variation, the exchanges would impose a special margin of 25 per cent or more on purchases in addition to the regular margin.

The suspension of trading, on account of market manipulation or price rigging is to be immediately advised by the concerned stock exchange to other stock exchanges who would also suspend the trading in that scrip. There is an Inter-Exchange Coordination Group (ICU) being set up. All the exchanges are the members of this group.

2. Surveillance and Enforcement: With a view to protect the integrity of the markets, the SEW introduced strong and effective enforcement measures against violations by intermediaries. The stock exchanges were asked to implement uniform norms for the imposition of circuit breakers and trading suspensions in cases where price manipulation was suspected. These measures included penal margin on net undelivered portion at the end of the settlement special margin for buyers in case of a rise in the share prices and joint suspension of trading the stock exchanges in case of price stipulation. All exchanges have set up Surveillance departments which coordinate with the SEBI. A trading data base has been created within the SEMI for trades on National and Mumbai Stock Exchanges.
3. Insider Trading: Insider trading in the securities is sought to be prohibited by the SEBI by Insider Trading Regulations, 1992.

SEBI Insider Regulation, 1992 defines the insider as any person who is or was connected with. the company or is deemed to have been connected with the company and who is reasonably expected to have access by Virtue of such connection, to unpublished price sensitive information with respect to the securities of the company or who has received or has - had access to such unpublished price sensitive information.

**Insider Dealing**

The SEBI Insider Regulation Act, 1992 prohibits dealing, communicating, or counseling on matters relating to insider trading. It. has been laid clown that no insider shall:

1. Communicate any unpublished price sensitive information with or without his request for such information; and
2. Counsel or procure any other person to deal in the securities of any company, on the basis of unpublished price sensitive information.

SEBI, after the investigation and hearing of the insider, can give directions to protect the interests of investors, securities market and due compliance of the SEBI Act, 1992. SEBI has also powers to initiate criminal prosecution under Section 24 of the SEBI Act of 1992.

**Penalties**

SEBI has been empowered to penalize or punish in contravention with the SEBI. Act as given under:

1. Non-compliance- of, returns and information: SEBI can impose- Rs. 1 lac per day with a maximum of Rs. 1 crore when returns, information and documents are not submitted.
2. Inability of redressal of Investors' Grievances: Under Section 15 C, SEBI can impose penalty of Rs. 1 lac per day or maximum of Rs. crore on those registered intermediaries or listed company which has not redressed the grievance of investors.

3. Defaulter in case of mutual funds: Under Section 15 D of the SEBI Act in case of mutual funds hot complied penalty can be imposed up to RS. 1. lac per day with the maximum of Rs. 1 crore.
4. Defaulter in case of stock broker: Under Section 15 F if any broker does not handover the security in time a penalty can be imposed at least Rs. 1 lac per day and with maximum of Rs. 1 crore.
5. Internal trade transactions: Any defaulter has to pay Rs. 25 crore or three times of the profit of internal trade transactions under section 15 G of the Act.
6. Unfair trade practices: If any person deals in unfair trade policies in securities, there is penalty provision of Rs. 25 crore under Section 15 HA of the Act.
7. Power of adjudicate: Under Section 15A, 15B,. 150, 15D, 15E, 15F, 150, 1514, 51-IA, 151-113 any person can be appointed by the SEBI for adjudication.

Appellate Tribunal Board has also been setup which provides the right of appeal against any penalty imposed by the .SEBI.

Securities Appellate Tribunal (SAT) would not be bound by the procedure laid down by the code of criminal procedure. It would be guided by the principle of natural justice and .subject to other provisions of the SEBI Act/rules. To discharge its functions, it is vested with the same powers as vested in a civil court in respect of the following matters:
1. Summoning and enforcing the attendance of any Person and examining him on oath.
2. Requiring the discovery and production of documents.
3. Receiving evidences on affidavits
4. Issuing commissions for the examination of witnesses/ documents.
5. Dismissing an application for default or deciding it ex parte.
6. Setting aside any order of dismissal of any application or any other order passed by it exparte.
7. Any other prescribed matter.

**Power of Government to Issue Directions**
In exercise of its powers or the performance of its functions under the SEBI Act, the SEBI would be bound by such directions on questions of policy as the central government may give in writing to it from time to time. The decision of the government whether a question is one of policy or not would be final.

**Power of Central Government to Supersede SEBI**
If at any time the government is of opinion (i) that- on account of grave emergency, it is unable to discharge the functions and duties imposed on it by or under the provisions of the SEBI Act or (ii) that it has persistently made default in complying with any directions issued by the government or in discharge of its functions and duties and as a result of such default its financial position or its administration has deteriorated or (iii) that circumstances exist which rendering it necessary in the public interest to do so, the government may, by notification, supersede the SEBI for a period not exceeding-six months.

**Returns and Reports**
The SEBI should furnish to the government at such time and in such form and manner as may be prescribed or as it may direct, such returns and statements and particulars in regard to any proposed or existing program for the promotion and development of the securities market from time to time, within 90 days after the end Of each financial year-the SEBI should submit to the government a report on the prescribed form, giving a true and full account of its activities, policy and programmes during the previous financial year.

**Delegation**
The SEBI may delegate to any of its member officer or any other Person subject to such conditions as may be specified in the order, such of its powers and functions under the SEBI Act except the powers to make rules.

**Offences**
If any person contravenes undo the provisions of the SEBI Act/ Rules/Regulations, he would be punishable with the imprisonment for a term which may extent to ten years or with the fine which may extend to Rs. 25 crore or with both.

If any person fails to pay the penalty imposed by the adjudicating officer he would be punishable with imprisonment for a term not less than one month but it can be extended to ten years or with fine, which may extend to Rs. 25 crore or with both.

**Power to Make Rules**
The government may by notification, make rules for carrying out the purposes of the SEBI Act. Such rules may provide for all or any of the following :

1. The term of office and other conditions of service of the chairman and the members of the SEBI.
2. The additional functions that may be performed by the SEBI.
3. The manner in which the accounts of the SEBI would be maintained.
4. The manner of enquiry.
5. The salaries, allowances and other terms and. conditions of services of the presiding officer, members and other officers and employees of the SAT
6. The procedure for the investigation of misbehaviour or in capacity of the presiding officers or others members oldie SAT
7. The form in which an appeal may be filed before the SAT and the fees payable iii respect of such appeal
8. The form and. the manner in which returns and report to be made to the government.
9. Any other matter which is to be prescribed, or in respect of which provision is to be made by rules.

**Ombudsman/Stipendary Ombudsman Regulations, 2003**
To redress the grievances of investors in 'securities and for connected matters, the SEBI has established ombudsman/stipendary ombudsman as per the following stipulations.

The SEBI may appoint one or more ombudsman/stipendary ombudsman for specified territorial jurisdiction: The office of the Ombudsman would be located at the head office/other specified offices of the SEBI.

**Qualifications**
The Ombudsman should be a (i) Citizen of the -India (ii) of high moral integrity (iii) not below 45 years of the age (iv) either a retired judge (v) having a minimum of 10 years experience in any regulatory body (vi) having special knowledge and experience in law, 'finance, corporate, matters, economies management/ administration for at least 10 years (vii) an office bearer of investors association recognized by the SEBI.

**Powers and Functions of Ombudsman**
An ombudsman would have the following powers/functions:

1. To receive complaints specified below against any intermediary/ listed company/both. The complaint on the following grounds may also be lodged with the SEBI in addition to the ombudsman concerned.

- Non-receipt of refund Orders / allotment letters in respect of public issue of securities of companies/ unity of mutual funds or collective investment schemes.
- Share certificates, Unit certificates, debenture Certificates, bonus shares
- Dividend by share/unit holders
- Interest on debentures, redemption amount of debentures or interest on delayed payment of interest on debentures
- Interest on delayed refund of application money
- Annual reports
- Redemption amount from mutual funds/ return from collective investment scheme
- Letter .of offer
- Statement of holding corporate benefits or any grievances in respect of corporate projects.

2. Non-transfer of securities by any issuing company.
3. Any grievances in respect of Public/rights/bonus issues of a listed company.
4. Any of the matters covered under section 55A of the Companies Act.
5. Any grievances in respect of issues/dealing in securities against any intermediary/listed company

**Power of the SEBI to Issue Directions**
The SEBI in the interest of the securities market and without prejudice to its right to initiate action including criminal prosecution under section 24 of the SEBI Act, give directions as it deems fit as given under:

1. Directing the person concerned not to further deal in securities in any particular manner.
2. Prohibiting the person concerned from cancelling any of the securities bought back inviolation of the companies Act.
3. Directing the person concerned to sell or divest the securities acquired inviolation of the provisions of the regulations or any other law or regulations.
4. Taking action against the intermediaries registered with the SEBI in accordance with the regulations applicable to them.
5. Prohibiting the persons concerned its director, partners, members, employees and associates or such persons from .assessing the securities market.
6. Disgorgement of any ill gotten gains or profit or avoidance of loss, and
7. Restraining the company from making a further offer for the buy back.

In case any person is guilty of insider trading or market manipulation, the person concerned should be dealt with in accordance with the provisions of the SEBI (Insider Trading) Regulation, 1992 and the SEBI (Prohibition of Fraudule and unfair Trade practices relating to the Securities Market) Regulation, 1995.

**Role and Achievements of SEBI**
Securities and Exchange Board of India (SEBI) was given statutory powers with effect from 4th April, 1992. It has been playing an important role in Indian capital market. It regulates and controls the financial institutions, agencies; stock exchanges, mutual funds, merchant bankers, primary and secondary markets on the one hand and it provides guidance, planning and development on the other. The role of SEBI is not only limited to primary and secondary markets but the .adequate. Development of these markets is also related with it. The role of the SEBI can be studied under the following heads:

**Role of SEM in New Issue Market or Primary Market**
SEBI has improved in the process of New Issue Market or Primary Market relating to issue of shares and debentures. It has played an important role in the protection of small investors' interest as given under:

1. Reform in Company Prospectus —SEBI has brought transparency in the company prospectus and for that purpose new subjects have been added in its outline. Now company cannot deceive investors by giving fictitious and deceitful facts in the prospectus and companies are supposed to follow code of advertisement. Prices of securities and premium determination are the physical facts which are given in the prospectus of the company. If the company gives wrong facts then the directors are liable to be punished under the SEBI Act. Risk factors are also mentioned in the prospects by the company. There is legal provision for compulsory publication of these facts in the prospectus.
2. Provide Information of Risk Factor—As per the directions of the SEBI each company participating in public issue it is an obligation to make available the information relating to risk factors. In order to protect investors and the information relating to the following is to be given:
   - Issues of a project, commencement of the project, cost, object, legal formalities to be obtained, to seek license etc.
   - Production process of the project, availability of raw material, regular supply, import of machinery, production capacity etc.
   - Possible markets of the project need of foreign exchange and supply, activities of product marketing etc.
3. Issue and Allotment of Shares —SEBI has also played an important role in issue and allocation of shares. A restriction from the price determination and premium on shares issued by the company's in the primary market has been withdrawn. Company can determine the price and premium of its shares after seeking permission from the SEBI as per rules. Permission of Registrar is essential in case of right issue. If the issue is more than Rs. 100 crore then there is need of account books.

There is also role of SEBI in the allocation of shares. Shares are allocated in proportion. A fixed proportion allocation is allowed in case of mutual funds anti foreign institutions. Under this scheme such individual investors who have applied for 1000 securities at least 50% of net proposals should be reserved. Similarly the applicants who apply more than 1.000 securities should be allocated from the remaining securities. If the subscription is ones subscribed, then the representative of SEBI can enquire about the allocation process. It is compulsory allocate within 30 days from the closing date otherwise 15% interest per annum has to be paid.

4. Underwriting and Listing of Shares —SEBI also plays an important role in 'underwriting and listing of shares. Prior permission is taken for underwriting of any public issue in the beginning. But now SEBI has removed such restriction. The number of underwriters was 4 only during 1.994-95 which has increased to 40. The SEBI has taken strict action against directors who have not followed 'listing agreement'.
5. Registration of Commercial and Merchant Banks—SEBI has made it compulsory for commercial and merchant banks who are managing issue and portfolio to get registered. The SEBI has registered 77 commercial banks who are engaged in issues and 13 commercial banks who were engaged in portfolio management. Similarly 100 commercial banks have been permitted by the SEE to work as portfolio managers. –

SEBI has also made it compulsory to seek registration in case of merchant bankers who are engaged in issues in primary market and some of the companies have been allowed to work as merchant bankers.

6. Protection to Investors—SEBI has played an important role in protecting the interest of investors as given under :
   - To set up an Investment Education and Protection Fund.
   - To improve the prospectus.
   - To improve the advertisement of issues.
   - To decide the minimum subscription in the issues.
   - To setup grievance cell.
   - To protect -investors under different sections of the Company Law.
   - To bring transparency in issues.

**Role of SEBI in Secondary Market**

The functions of stock exchanges have been improved by the SEBI in secondary market. The SERI has played its role in the secondary market as given under :

1. Supervision of Stock Exchanges —SEBI has inspected various stock exchanges in the country from time to time and several measures have been incorporated in their inspection report. There are 23 stock exchanges working in the country. Whether all these stock exchanges are following the rules and directions of the SEBI, is being inspected.
2. Reorganization of Stock Exchanges—The reorganisation of various administrative boards and various committees are based on the reorganised board. SEBI has given several directions to stock exchange centres to make their operation competitive and to have an effective Control on them. Organisational changes have been, introduced by the SEBI in disciplinary, mediation and lapse committees.
3. Registration of Stock brokers, Sub-brokers and Functionaries--SEBI has made it compulsory to get registered with regard to all working in stock exchange centres as brokers, 'sub-brokers, jobbers, registrars, underwriters, share transfer agents etc. SEBI has issued several directions to have an effective contra the brokers and. other functionaries.. The capital limit has been fixed to have financial control with 3% in case of brokers and 6% in case of Members of corporations. Permission has been given to members of the corporation in stock exchange centres and to encourage and to give them preference bye laws of stock exchange centres have been amended. This has increased the membership. There are 8746 stock brokers, sub-brokers and 1916 corporate members in the country.
4. Transparency in Working or Stock-Brokers--SEBI has taken_ several measures to bring transparency in the working of stock brokers. The measures are as given under::

- Brokers have to keep separate accounts of their customers and of themselves.
- To submit the report to SEBI relating to audit of accounts every year.
- The contract letters to stock brokers should be issued within a day in stock exchange centres and the exchange rate and the brokerage should be mentioned separately.
- Stock brokers and sub-brokers have to get registered in SEBI and stock exchange centres at one time.
- Stock exchange centres have amended their listing contract and under this amendment a copy of cash flow statement, balance sheet and profit '8z less account will be made available corporate agent shareholders.
- The time limit of stock brokers has been fixed the payment of transfer of shares and the difference of price variation of shares transferred to shareholders by the stock brokers has also been fixed. In case of default there is penalty provision fixed by the SEBI.

5. Classification of Issue. Registrar and Share 11-ansfer Agent—In order to make more competent to the Registrar of Issue and Transfer Agent the SEBI has categorized them into two as given under:

In the first category there should be at least Rs. 6 lac to work together the Registrar of Issues and Transfer Agent. In the second category any one requires at least Rs. 3 lac. Upto the end of 1997 the number in the first category was 209 and in case of second category it was 125 only.

6. Permission to Foreign Institutional Investors.—SEBI has permitted Foreign Institutional Investors (Ells) to participate in Indian Capital Market. SEMI has been providing various types of facilities. This is the greatest achievement of the SEBI. The facilities provided to are as given under:

- Foreign-Financial Investors have been permitted in Indian capital market as mutual funds, pension fund, investment trusts, corporate companies, capital management companies etc.
- Foreign stock brokers have been permitted to purchase and sell of shares.
- Foreign firths have been allowed to set up joint enterprise in financial sector.
- Foreign investor can invest to the maximum of its 30% issued capital in portfolio investment in Indian company.

- Foreign investor has right to take away interest capital profit and dividend to his country.
- Foreign investor has been allowed to open his bank account.

7. Internet Trading—SEW has permitted the registered stock brokers under order routing system to have internet trading. Each customer purchase and sell his shares through internet on his computer. The permission of clearing houses has been given to stock exchange centres. Cent percent modernization of stock exchange centre has been done. All the 23 stock exchange centres are connected with internet and it has reduced the cost of their transactions.
8. Role in Other Matters — SEBI has played an important role in other matters of secondary market. These matters are given below :

- SEBI has accepted the recommendations of the Dave Committee relating to Over the Counter Exchange of India (OTCEI).
- Mumbai stock exchange centre has reduced the business period of B Group shares from 14 days to 7 days.
- The business hours in each stock exchange centre has been increased from 2½ hours to 3 hours daily.
- Registration of merchaW0-ilankers and portfolio managers has been made compulsory. Any mistakes committed by merchant bankers have been made known through penalty provisions under the SEBI Act.

If any merchant bankers commit mistakes 8 times then they can be suspended or declared unauthorized in capital market. 231 merchant bankers were registered under the Act. Out of these registration of 29 has been cancelled. At present there are 1012 merchant bankers in the capital market.

**Helpful in Market Development**
SEBI has helped in the development of the market. `Market Maker' is appointed by the SETH on the recommendations of stock exchange centres. Market makers bring liquidity in shares and remove the fluctuations in the prices of-shares.

**Dematerialization of Shares**
Dematerialization of shares has been made compulsory by the SEBI 50 percent of business of stock exchange centres is in the form of dematerialization. Such business has attracted the foreign institutional investors (FIIs) in the capital market. Dematerialization business has solved several problems of transfers in the market.

**Commencement of Derivatives Business**
Derivatives business has been allowed by the SEBI in the secondary market. Derivatives are considered securities. It is not actually handed over and it is also not useful in the mobility of assets. Future, opinion, swaps, warrant, and convertible are main financial derivatives in Indian market. All are used to make 'Future options'. Some derivatives are standardized and related With exchange trade. There are more chances of speculation and risks in derivatives. It increases the convertibility.

**Circuit Breaker System**
SEBI has started circuit. Breaker system in order to check fluctuations in individual stock market. Under this system if in any stock exchange centre the market mobility goes beyond a limit, then SEBI can stop the transactions in such a market. The system aims at to check fluctuations in the form of speculative activities. This system of SEBI is considered more reliable.

**Conclusion**
The role of the SEBI has been very important in primary as well as secondary market. The guiding principles of SEBI have increased the confidence of investors in the primary market. False, deceitful and fictitious statements issued by the companies are now being controlled by the SEBI and investors are

not prey of such activities in the, primary market. In some cases penalty provisions have been provided by the SEBI which are protecting the interests of the investors. In secondary market SEBI has been controlling the activities of stock exchanges on the one hand strict rules and regulations and reforms have been provided to check on the undesirable activities of stock brokers and stock sub-brokers. New reform the form of market makers, internet trading, modernization of stock exchanges, derivatives business, Investors Grievance Cell etc. in the secondary market. Positive decisions have been taken by the SEBI relating to Foreign Institutional Investors which are important achievements of SEBI. These achievements of SEBI have consolidated the capital market and transparency has been made possible.

**Unit – 5**

**LEASE FINANCING & HIRE PURCHASING**

**Lease Financing**

A lease is a contract whereby the owner of an asset (the lessor) grants to another person (lessee) exclusive rights to use the assets for an agreed period of time, in return for the payment of a rent (called lease rent). There is no separate Act in India to govern the contract of leasing. The Provisions of the Indian Contract Act apply to it.

**Duties of Lessor:**

1. Lessor has to deliver the assets to the lessee
2. Transfer the rights to use the assets exclusively to the lessee —

**Duties of Lease:**

1. Pay the lease rentals to lessor
2. Protect lessor's title
3. Take reasonable care of the assets
4. Return leased assets after the expiry of the lease period.

**Features of leasing:**

1. Valid leasing contract should exist
2. In case of movable assets the lessor must deliver it to the lessee and in case of immovable assets the possession of the goods should be given to the lessee.
3. Specific purpose for the leased assets
4. Lease rentals as consideration,
5. Only possession and the right to use is transferred, there is no transfer of the ownership
6. Return of assets after the expiry of lease period.

**Types of Lease:**

1. Operating Lease: The primary lease period is short and the lessor would not be able to realize the full cost of the equipment and other incidental charges thereon during the initial lease period. The lessor has to bear insurance, maintenance and repair costs etc. Agreements of operating lease generally provide for an option to the lessee/lessor to terminate the lease after due notice. These agreements may generally be preferred by the lessee in the following circumstances:–
   - When the long-term suitability of Sets is uncertain.
   - When the assets is subject to rapid obsolescence.
   - When the assets is required for immediate use to tide over temporary problems.
2. Finance Lease: Finance lease is a long term arrangement, which is irrevocable during the primary lease period which is generally the full economic life of leased asset. This is a closed ended arrangement with no option to lessee to terminate the lease agreement subsequently. The lessee has to bear insurance, maintenance and other related costs Variants under financial lease are as under:-
   - Lease with purchase option after the expiry of lease period at an pre agreed price.
   - Lease with residual benefits.

**Advantages of Lease:**

1. Flexibility: The leasing company in most of the cases would be prepared to modify the arrangement to suit the specific requirements of the lease.
2. 100% Finance: There can be lease finance upto 100% cost without any initial disbursement.
3. No lengthy procedure: Banks/financial institutions may involve lengthy appraisal and impose stringent terms and conditions to the sanctioned loan. In contrast leasing companies may arrange for immediate purchase equipment on mutually agreeable terms.

4. Documentation: There is no lengthy and time consuming documentation procedure.
5. No Obsolescence risk: In short tern lease, the lessee is safeguard against the risk of obsolescence.
6. The leased asset does not affect the borrowing capacity of the lessee as lease payment may not require normal lines of credit and are payable from income during operating period.
7. By using sales and lease back the assessee may overcome a financial crisis by immediately arranging cash resources for same emergent application or for working capital.

**Disadvantages of lease**

1. The lease rentals become payable soon after the acquisition of asset & no moratorium period is permissible.
2. The sellers' warranties for satisfactory operation of the leased assets may sometimes not be available to lease.
3. If the lease asset is acquired by the lessor through credit facilities, default in payment by the lessor may sometimes result in seizure of the assets by banks/financial institutions causing loss to the lessee.
4. Lease financing has very high costs of interest as compared to interest charged on term loans by financial institutions/bank.

**Difference between finance lease & operating lease**

| Base | Finance Lease | Operating Lease |
|---|---|---|
| Life of Contract | Approx the economic life of the asset | Shorter than the economic life of the assets |
| Maintenance | Provided by the lessee or covered by a separate agreement. | Provided by the lessor & include in lease rentals. |
| Lease Payment | Return the cost of the assets and allow a profit to the lessor | Not sufficient to cover the cost of the asset |
| Cancellation | May be cancelled only if both the lessor and the lessee agree. | May be cancelled before expiry date after giving a due notice either by lessor or lessee . |

**Hire Purchase**

In hire purchase transaction the goods are let on hire, the purchase price is to be paid in installments and hirer is allowed to purchase the goods by paying the entire installment. A hire purchase agreement is defined as a peculiar transaction in which the goods are let on hire with an option to the hirer to purchase them, under the following Stipulations:-

- Payment to be made in installments over a specified period
- The possession is delivered to the hirer at the time of entering into the contract
- The title of the goods passes to the hirer on payment of the last installment
- Each installment is treated as hire charges which enables the seller to take away the goods in case of default
- The hirer can return the goods without any obligation to pay further installments.

**Difference between hire purchase and lease financing**

| Base | Hire Purchase | Lease Financing |
|---|---|---|
| Ownership | It passes to the user (hirer) on payment of last installment | The lessor (finance company) is the owner. It never passes to the lessee. |
| Down payment | 20%-25% of the cost is paid as initial down payment | There is no down payment in lease financing. |
| Deprecation | Deprecation is charged in books of hirer (user) | Deprecation is charged in the books of lessor (owner) |
| Maintenance | Cost is borne by the hirer (user) | In operating lease it is charged to lessor (seller) and in case of finance lease it is |

| | | |
|---|---|---|
| | | charged to lessee |
| Capitalization | It is done in the books of hirer. | It is done in the books of leasing company |
| Risk Obsolesce | The risk of obsolesce is born by hirer | In operating lease it is borne by lessor/seller & in case of finance lease it is born by lessee. |
| Reporting | The assets/equipment is shown in Balance sheet of hirer and the installment payable as a liability | The assets/equipment is shown as a footnote in the balance sheets |

**Between Hire Purchase and Installment payment system**

| Base | Hire Purchase | Installment payment system |
|---|---|---|
| Ownership | It passes to the user (hirer) on payment of last installment | Ownership passes to the purchaser simultaneously with the payment of initial installment. |
| Call Option | Hirer has the right to terminate the contract at any time before the payment, of last installment. | Buyer is committed to pay the full price. |

**INDUSTRIAL FINANCIAL INSTITUTION**

The sources of industrial finance were extremely inadequate to meet the growing demands of finance Of the existing industries, not to speak of Many new industries which were coming up, the Government of India set up in 1948 the Industrial Finance Corporation of India to grant loans and advances to industrial concern-s, to -subscribe to the debentures floated by them and to underwrite new issues of stocks and debentures of industrial concerns. In 1955, the Industrial Credit and Investment Corporation of India (I.C.I.C.I.) was set up to promote new industries, expand and modernize existing ones, to encourage the inflow and participation of foreign capital in Indian private enterprises and to furnish technical and managerial aid. The Government has also set up the Industrial Development Bank of India (I.D.B.I.) and the Unit Trust of India (U.T.I.) as important sources of industrial finance. The Government set up the National Industrial Development Corporation (N.I.D.C.) and the Refinance Corporation for Industry also to assist industrial financing.

**6. Industrial Finance Corporation of India (IFCI)**

The IFCI was the first development bank established in India in 1948. It was converted into a Public limited company with effect from 1 July 1993. Its main objective is to make medium and long term credit to industrial concerns in the private, public, joint and cooperative sectors in India. It is a subsidiary of the IDBl which holds 50 per cent of its share capital-and the remaining 50 per cent is held by banks, insurance companies and cooperative banks. It augments its resources by borrowing from the Government of India, RBI, IDBI, UTI, LIC and by issuing its :Bonds and debentures in the market arid by borrowing in foreign currency from the World Bank and other foreign organizations.

**Its Functions**

The IFCI performs the dual function of a financier and promoter. These functions reveal its multifaceted activities.

g. It sanctions loans and advances to industrial units and also subscribes to the debentures issued by them, provided they-are repayable within 25 years front the date of issue.
h. It guarantees loans floated by the industrial concerns in the open market, provided they are repayable within 25 years.
i. It underwrites the issue of stocks, shares, bonds and debentures floated by the industrial concerns.
j. It can subscribe units.
k. It can sanction loans and advances to public limited companies and cooperative Societies, but 'not to a private limited company or a partnership firm.

l. It can grant only medium-term and long-term credit assistance to industrial units:

**7. Industrial Development Bank of India (I.D.B.I.)**

The Industrial Development Bank of India (MBA.) was premier tetra-lending institution devoted exclusively to financing the requirements of industries in India. The I.D.B.I was set up in July, 1964, as a wholly owned subsidiary or the Reserve Bank of India. With effect from February 16, 1976 it was delinked from the RBI and made an autonomous corporation fully owned by the Central Government.

**Its Functions**

The IDBI is an apex institution hi the sphere of development banking in India which performs financing, coordination and promotional functions. It renders assistance to small, medium and large scale industries in public, private, joint and cooperative sectors.

i. Schemes of Direct Assistance: It extends direct assistance to industry under its Project Finance Scheme and the Technical Development Fund Scheme. The Project Finance Scheme also covers assistance under the Textile Modernizations Fund, Venture Capital Fund, Technology Up gradation Energy Audit Subsidy and Equipment Finance for Energy Conservation Schemes.
j. Refinance of Industrial Loans: It renders indirect assistance by refinancing the term loans extended by SFCs, SIDCs, commercial/cooperative banks and RRBs to industrial concerns.
k. Bills Rediscounting Scheme : This scheme is meant to help the use of indigenous machinery by industrial concerns. Under this scheme, the purchaser draws the bill in favor of the manufacturer of machinery who discounts it with his banker who in turn gets it rediscounted from the IDBI. This facility is provided mainly to sugar, jute, cotton textiles, cement and engineering industries.
l. Seed Capital Scheme: Under this scheme, financial assistance is available to new entrepreneurs for meeting the gap in promoter's contribution as well as equity where no issue of public shares is done,
m. Assistance to Leasing Companies: Financial assistance is also sanctioned to leasing companies for refinancing their hire-purchase and leasing schemes.
n. Resources Support to Other Institutions: The IDBI provides resource Support to other financial institutions by subscribing to their shares and bonds/debentures such as that are issued by IFCI, IC ICI, SFCs, SIDCs, NS1C, TCOs etc.
o. Merchant Banking: It carries out merchant banking activities and helps industry in raising capital from the market and renders advice,
p. Commercial Banking: It has set up the 10131 Bank Ltd. since 1995 as a private commercial bank.

**8. Industrial Credit and Investment Corporation of India (ICICI)**

The ICICI was established in January 1955 as a public limited company. It is a private sector development bank in India. The World Bank played a key role in its formation. Its authorized capital is Its 100 crones. About 11 percent of its share capital is held by the World Bank and other foreign financial institutions and the remaining by Indian Banks, M. GIC, LIC etc. During 1990-91 for the first time, ICICI entered the, capital market with a public issue and raised Rs. 100 crores.

**Its Functions**

The ICICI renders both financial and promotional assistances private, joint, public and co-operative sector industrial concerns.

**Financial Assistance:** The ICICI provides financial assistance of the following types:

- Project Finance: Assistance for project finance is by way of rupee and foreign currency ions, underwriting and direct subscriptions to shares and debentures and guarantees.
- Financial Services: Assistance by way of financial services to industry includes assistance under schemes of deferred credit since 1982-83, equipment leasing since 1983-84, venture capital

during 1986-87 to 1987-88, installments sale since 1988-89 and asset credit facility since 1989-90,

- Merchant Banking: The ICICI also renders merchant banking services.
- Commercial Banking: It has set up the ICICI Banking Corporation as a commercial bank since 1994.

**Its Working**

Financial assistance sanctioned and disbursed by the ICICI during 1999-2000 amounted to Rs. 44,479 crores and Rs, 25,836 crores respectively. Of the total disbursed amount, rupee loans, foreign currency loans and guarantees amounted to Rs. 17,597 crores; underwriting and direct subscriptions Rs. 5,248 crores; and others Rs, 2,991 crores. The ICICI is required to achieve 8% capital adequacy norm since 1993-94 which it has been maintaining on an average of 10%.

**9. State Financial Corporation's (SFCs)**

SFCs. are the state-level development banks for the development of small and medium scale industries in 18 States of India. They aim at bringing about balance regional development by wider dispersal of industries, promoting greater investment and generating large employment opportunities. Besides their paid-up capital, SFCs augment their funds by borrowings from the Governments, RBI, IDBL banks and by Way of bonds/debentures, by accepting deposits and sale of investment in shares and debentures of industrial concerns.

**Functions of SFCs**

g. They provide financial assistance to industries by Way of term loans, direct subscription to equity/debentures, discounting of bills exchange and guarantees.
h. They meet the term loan requirements of small and medium 'scale industries for acquisition of fixed assets like land, building machinery and equipment.
i. They provide loans for setting up new industrial units as well as for-expansion and modernization of the existing units.
j. They also promote the development of medium and small scale industries in backward area of the country.
k. Under the Special Capital Scheme, SFCs provide equity type support of up to Rs. 4 lakhs on soft terms to entrepreneurs for bridging the gap in equity or promoter's contribution. Entrepreneurs with viable projects but lacking adequate own funds are assisted under the scheme.
l. SFCs operate a number of schemes on behalf of the IDBI. These include composite loan scheme, schemes for women entrepreneurs, modernization scheme, equipment finance scheme, schemes for hospitals and nursing homes, scheme for ex-servicemen, single window scheme and special capital and seed capital schemes.

10. **The Export Import Bank of India (EXIM Bank) :** Set up in 1982, Exim Bank has diversified its activities from export credit to a source of comprehensive financial packages to enable Indian Companies to enhance their export production capabilities. It decided to provide self liquidating loans in foreign currency for meeting project expenditure relating to import of capital goods, raw material, components, technology as well as local rupee cost of projects. Bank offers foreign currency loans under the new facility at Libor, plus a reasonable spread, based on the Banks cost of foreign currency funds. While the exchange of the rupee has been stable Net Foreign Exchange Earners (NFEE) are in any case protected against exchange risk since the export cash flows give them a natural hedge in the event of rupee depreciation.

## MEANING AND NATURE OF FACTORING

Factoring is a mechanism of managing financing and collecting receivables in developed countries like USA and like proof. P.N. Biscoe has defined factoring as “a business involving a continuing legal relationship between a financial institution the factors and a business concern the client selling goods or providing services to trade customers the customers where by factor purchase the clients’ accounts receivable and in relation there to controls the credit, extended to customers and administers the sales ledger.

**Factoring services- The factor provides three basic services to clients -**

1. Sales ledger administration and credit management
2. Credit collection and protection against default and bad debt losses
3. Financial accommodations against the assigned took debts

**Types of Factoring –**

1. **Recourse factoring**- Recourse factoring does not include bad-debts protection
2. **Non-recourse factoring**- Under non-recourse factoring, the factor’s obligation to the client becomes absolute on the due-date of the invoice, irrespective of the payment made or not made by the trade debtors
3. **Advance and maturity factoring** –sometimes, the factor and the client make on arrangement whereby factor pays a pre-specified portion of the factored receivables in advance to the client on submission of necessary documents, this type of management is known as advance factoring
4. **Old line factoring**- It provides an entire spectrum of services, such as collection, credit protection, sales ledger administration, and short-term finance.
5. **International factoring**- In international business transactions, factoring services are provided by factors of both countries, that is, the exporter country’s factor and the importer counties factor.
6. **Invoice discount**- It provides finance against invoices backed by letters of credit of banks.

**Advantages of Factoring-**

**Benefits to the clients-**

1. The client’s credit sales are immediately converted into ready cash s the factor makes a payment of around 80% of the factored invoice in advance.
2. The client can offer competitive credit terms to his buyers
3. The cash realized from credit sales can be used to accelerate the production cycle.
4. The client is free from the tensions of monitoring his sales ledger.
5. Factoring results in a close international among working capital components of the business.
6. The client can expand his business by exploring new markets.

**Benefits to the customers (buyers)**

1. Factoring facilitates the credit purchases of the customers as they get adequate credit period.
2. Customers save on bank charges and expenses.
3. The customer has not to furnish any documents.
4. Factoring does not impinge on the customer’s rights vis-à-vis the supplier’s in respect of quality of goods, contractual obligations and so on.

**Forfeiting**- Forfeiting is the discounting of International trade receivable on a 100 percent without resource basis. Forfeiting converts the exporter’s credit sale into a cash sale. By transforming the exporter’s credit into a cash transaction, it protects the exporter from all the risks associated with selling overseas on credit.

**Characteristics of Forfeiting Transaction-**

1. Forfeiting is 100 percent financial without recourse to the exporters.
2. Trade receivables are usually evidenced by bills of exchange, promissory notes or a letter of credit.
3. Credit periods can range from 60 days to 10 years.
4. Forfeiting is flexible
5. An importer's obligation is normally supported by a bank guarantee or annual.
6. Forfeiting is suitable for high value exports.

**Benefits of Forfeiting**

1. The exporter receives the full export value from the forfeiter.
2. The eliminates risks such as commercial risks, political risk, exchange risk etc.
3. It improves the liquidity of the exporter as it converts credit sales into a cash transaction.
4. It also receives the balance sheet of contingent liabilities and helps the exporter to the undertake more exporter.
5. It enhances the competitive advantage of the exporter.
6. It relives the exporter from administration and collection hassles.
7. Its documentation procedure is simple.
8. It does not affect the exciting banking limits of the exporter.
9. The exporter saves on insurance costs as Forfeiting obviates the need for export credit insurance.

# Unit – 6
# Credit Rating in India

**Concept and Meaning of Credit Rating**

Investors are interested to invest in those securities which are riskless or the risk is minimum. Credit rating attains this objective of investors. The superiority of securities is based on the rate of returns from these securities. If it is known that the rate of return on the securities is ascertain and the principal as well as interest will be safe then such securities are considered good or superior securities.

Credit rating is a codified rating assigned to an issue by authorised credit rating agencies. Credit rating is a relative ranking arrived at by a systematic analysis of the strengths and weaknesses of a company and debt instrument issued by the company, based on financial statements, project analysis, creditworthiness factors and future prospects of the project and the company appraised at a point of time.

Credit rating is always project/instrument specific. Credit rating for different instruments issued by the same company at the same time can be different. In the same way credit rating for similar instruments issued by the same company at different times can also be different. Credit rating is a concept, a strategy and trust which expresses the redemption of any instrument purchased by investor. Redemption of loan is based on several symbols which are given before the loan is raised by any person or organisation.

A few well known credit rating agencies have defined the concept in various ways as given under:

1. Credit Rating Information Services of India Ltd. (CRISIL) Rating : According to CRISIL "Credit rating is an unbiased, objective and independent opinion as to an issuer's capacity to meet its financial obligations. The CRISIL rating symbols indicate in a summarised manner CRIMES current opinion as to the relative safety of timely payment of interest and principal on a debenture, preference share, fixed deposit or short term instrument".
2. Moody's Investor Service (USA) has defined, "Rating is designed exclusively for the purpose of grading bonds according to their investment qualities."
3. Standard and Poor's (USA) has defined, "A standard and poor's corporate or municipal debt rating is a current assessment of the credit worthiness of an oblizer with respect to specific obligation."
4. **Australian Ratings—**According to it "A corporate credit rating provides landless with a simple system of gradation by which the relative capacities of companies to make timely repayment of interest and principal on a particular-type of debt can be noted."

In brief we can say that a credit rating is not a general evaluation of the issuing organisation. It generally reflects the probability of timely repayment of principal and interest by a borrowing company. The system of credit rating is not a onetime evaluation of credit of a security.

The following conclusions can be drawn on the basis of credit' rating:

1. Credit rating does not recommend for the purchase and sale of securities:
2. Credit rating does not create trustee relationship between credit rating agency and the company.
3. Credit rating does not rate the company for general objectives.
4. Credit rating does not verify the informations made available by the loanee/borrower.
5. Credit rating does not audit the functions of credit rating Company.
6. Credit rating does not evaluate the risk of securities one time but it evaluates the security for the whole of the life.

Thus above description reveals that the credit rating reveals the. redemption of loan taken by the issuer.

**Factors Affecting Credit Rating**

Credit rating of a Company is done by a credit rating agency which is affected by the following factors:

1. Terms form and quantum of securities issued.
2. Possibility as a defaulter in the payment by the issuer.
3. Ability and desire of the issuer to make payment of securities under contract.
4. Risk of industry
5. Area record, planning and control.
6. Protection given to investor in case of issuer is declared bankrupt and non-payment.
7. To pledge the assets of company as the security of securities.
8. Liquidity of assets.
9. Market conditions and account merit.

All the above factors affect the functions of credit rating agency. This company does work as an advisor, of the unit or business and can not reveal that investor should invest in particular securities. It does recommend to purchase and sale of securities.

The processes of credit rating of all companies are uniform. The credit rators are specialist in the area and are concerned with prestigious credit rating institutions. Under credit rating credit instruments are evaluated and whenever it is needed equity shares are also rated. Organisation cannot be categorised under credit rating but economic strongness, working system, managerial efficiency, managerial behavior, collective work etc. of the issuer is revealed by the credit rating organisation. There may be difference among different securities issued by issuer on the, basis of credit rating. Any organisation is rated on the request by credit rating agency and credit rating is done not of the organisation but its credit instrument. If there is any improvement in the grade of security instruments the agency will inform the issuer accordingly.

Credit rating agency carries classification regularly. It can be converted, suspended and taken back until the new information is not received.

**Objectives of Credit Rating**

The following are the objectives of credit rating:

1. It provides correct, authentic and at low cost informations to investors,
2. It implements the guidelines of the public to institutional investors.
3. It collects informations, encourages, complies accounting standards and to improve financial information.
4. It helps merchant bankers, stock brokers, officers etc. relating to borrowing matters.
5. It reduces the interest cost of high category's credit rating company.
6. It helps issuers for marketing the securities.
7. To increase the discipline in debtor so that payment is made in time.

**Functions of Credit Rating**

The following are the functions of credit rating:

1. Provide Information to Investors: Credit rating agency issues several important information in the interest of investors. Investors are worried about the security of his fund, adequate income, return of the principal while investing in securities. Possibility of risk is revealed impartially by the agency with credit rating relating to securities. Generally the interest of issuer; stock broker, financial intermediaries, underwriters etc. is involved in securities. Conclusions are drawn by the credit rating agency. The ability rating of personnel working in a business is also studied

and conclusions are drawn. Credit rating agency collects such information for investors which are not easily available.

2. Determination of Public Policy: Credit rating agency helps in the determination of public policy relating to securities. Various types of institutional securities are issued which are tested by credit rating of the security. They are trusted more. Guiding principles are formulated for issuing securities in future.
3. Valuation of Risk and Return of Credit Instrument: When credit rating agency determines the category or class of any credit instrument, it increases the confidence of investors in the market. Investors know about the risk involved in the instrument and take decision regarding the investment.
4. Creation of Financial Discipline: Financial discipline is created due to credit rating agency. The borrower has to give his credit, honesty, redemption capacity to the creditor. He has to repay the debt keeping in view the financial discipline. If Credit rating in a corporation is carried on, it reveals the better status and credit of the corporation.
5. To Give Financial Representation: Credit rating agency collects information relating to finance etc. of a security and on that basis certificate is issued. The reliability of certificate depends upon the working of credit rating agency. The reliability of certificate increases the confidence of the investors and the security provides the financial representation in the market.
6. Reduction in Expenses: credit rating agency collects information for which survey is conducted, primary and secondary data are collected, filling of schedules, verifying documents and all the informations are analysed and interpreted. All these informations are collected by well trained staff, Workers and employees on which heavy expenditure is incurred. An individual investor can collect all such information on his expenses. Thus credit rating agency reduces the expenditure or individual investor.
7. Business Analysis: A business firm is analysed under credit rating. Market conditions, business operation capacity, legal situation and risk etc. are analysed while credit rating of any firm. The market price of any company's or firm's securities, stability, competition with other securities, future marketing policy of organisation, research and development, product quality, after sales service etc. ire analysed. Under the operating capacity qualification of directors of company, availability of raw material, manufacturing process, labour relations, availability of capital; profit quantity analysis etc. are also analysed under credit rating. Risks involved in the business are also analysed by the credit' rating agency.
8. Managerial Valuation: It is done through inspection of the organisation. Managerial capacity is found out on the basis of past financial results, activities, planning and control system. Managerial ability, future planning, capital structure, board of directors and shareholders with their inter-relationship arc also found out. Credit rating agency concludes on the basis of managerial ability of an organisation.
9. Assets Analysis: Credit rating agencies analyse the movable assets and permanent assets of an organisation from different points of views. Under the movable assets the quantum of movable assets, liquidity, ratio in permanent assets, risk in movable assets etc. are taken into consideration. Movable liability, reserve fund, tax planning, capital structure, interest rate etc. are also considered. Analytical information is collected with reference to above items relating to financial company. All these informations benefit to investors.

**Advantages of Credit Rating**

Credit rating affects directly to investors as well as issuers. The advantages of credit rating are discussed as given under:

**I. Advantages to Investors**

Investors are benefited from credit rating as given under:

1. Safety of Investments: Each investor wants safety against his investment. When any instrument is rated by credit rating agency the financial position of the company is revealed. If the instrument is rated high, it means it is .less risky and well secured. Contrary to it when it is

rated low there is risk and investment is not safer. Thus credit rating provides security to investors.

2. Knowledge of Risk: Credit rating agency provides indicating symbol for investors. From this symbol investors take decision whether it wiseful to invest in the company or not. The risk is known to the investors.
3. Helpful in Investment Decision: Once the securities are rated by credit rating agency investors are prepared to invest blindly. They need not to analyse securities. Large investors take quick investment decisions.
4. Knowledge of Issuer Company: Issuers are not known to investors. Credit rating gives knowledge to the investors about the issuers. Credit rating agency rates the organisation independently. Issuers are not related with the credit rating agency. Hence the information is authentic and reliable. It increases the confidence of investors in securities.
5. No Need of Intermediary Services: Investors need not to seek the intermediary services from financial institutions, security brokers, merchant bankers, security managers, underwriters etc. Once the security instrument is credit rated by an agency, investor can invest without any doubt.
6. Selection of Securities: More than one rated securities are available to the investors in the capital market. They can select and invest in the correct security on the basis of credit rating by agency. The importance of securities increases with the credit rating. Once rating symbols of securities are given there is no need of selecting securities.

**II. Advantages to Issuer**

The following are the advantages to issuer on account of credit rating:

1. Reduce Cost of Public Issue: When the credit instrument of a company is rated high then it reduces the unnecessary expenses of the company. It reduces the cost of public issue because the expenses on large scale on advertisement, TV, radio, newspapers, journalist meet, media contact heed 'net to be incurred before the issue. Credit rating service helps the issuer in collecting more capital with less expenses.
2. Payment at Low Rate of Interest: On account of high rated company at low rate of interest capital is easily raised from the market. The securities, debentures, bonds and fixed deposits issued by the company are of low rate of interest. Investors invest more in those ventures where risk is minimum and safety and regular income are assured. Thus the issuing company has to pay low rate of interest to the investors.
3. Increasing Number of Investors: The number of investors increases on account of high rated company, continuous advertisement, coverage by large media and fame of the rated instrument. The repayment Of principal and interest also attracts investors. Issuers are in advantageous position as they can easily collect the capital on large scale with less efforts and there is no need of dependency on capital market for 'meeting capital requirements of the company.
4. Increasing Marketability: When an instrument is rated by credit rating agency, the marketability of the instrument increases. More efforts are not needed for the marketability of such instrument. Sometimes better market is available to unrated security of issuer. The demand for securities increases on account of credit rating and-more subscription is received.
5. Advantages to Unknown Issuer: Unknown investors also get fame on account of credit rating. Credit instrument and the company are known in the capital market. The prestige of the company increases in the market. Other financial institutions are also attracted towards such company.
6. Advantages to Financial Intermediaries: When the securities of a company are rated by an agency then the financial intermediaries need not to make efforts for marketing such securities in the capital market. Economic, commercial and marketing position of the company is not analysed. It reduces the cost of the company in the form of time, money and energy. It is assumed that the economic position is sound.

**Disadvantages of Credit Rating**

The following are the disadvantages of credit rating:

1. Lack of Qualitative Rating: Capital market, trade and industries are not qualitatively rated which leads to loss to investors. Comprehensive credit rating is done by credit rating Company on the basis that the credit rating company has no business relations with the business firm or company. On the basis of such impartial recommendations report is submitted to rating company. When the company is rated Walt there is no problem but when the company is rated low it is not mentioned by the company or Firm in advertisements. Investors are kept in dark by such low rated companies.
2. No Attention on Future Informations: Credit rating is done on the basis of present and past data of the business firm or company and rating is given. Once grading is allotted, no attention is paid in future. Political change, change in government's monetary policy, fluctuations in the economy etc. affect the operation system, commercial and financial position of the company and it increases the quantum of risk in the market. Thus credit rating does not take into consideration the future informations of the company.
3. Secrecy of Information: Institutions getting credit rating from the credit rating companies do not provide the cent percent information and some of informations are kept secret and consequently the rating which is given or assigned is not correct. Credit rating agency is also found in doubt in the market.
4. Change in Grade : Once a business firm is given high rate by the credit rating company, later on being deterioration in the working the rating is not changeable. If it is done then the credit of the business firm is adversely affected and investors think such company with doubt.
5. Effects of Unfavourable Conditions: The current prevailing market conditions affect the securities and their issuers. If the market conditions are Unfavourable; there will be adverse effect on the issue and the evaluator will evaluate at low rate. The company will not get adequate funds from the market and it will adversely affect the credit of the company in the market. For example, during depression production is adversely affected, sales is affected and it leads low profit and decrease in the rate of interest. Thus unfavourable conditions affect the investment opportunities.

**Rating Process**

The process of credit rating comprises of the following steps:

1. The credit rating process commences when a client approaches the credit rating agency to analyse and provide a rating symbol/report to a security/individual/borrower etc.
2. The credit rating agency assimilates all the necessary information required for this by meeting the management of the company. The information provided for the purpose will be highly confidential and will not be used for other purposes.
3. The credit rating is based on the analysis of the report.
4. The rating is communicated to the client along with the reasons supporting the rating. If the client does not agree with the rating he may appeal for reviewing the rating.
5. If the rating is accepted by the client it will be declared to the public by the credit rating-agency,
6. The rating is not a onetime process. There is a continuous monitoring of the client's performance and its operational: environment.

**Types of Credit Rating**

There is a large type of credit rating carried on by different agencies for different purposes. The types of credit rating are discussed as given below:

1. Bond or Debenture Rating: When any corporation, company or government floats bond or debenture in the market, it is called bond/debenture rating.
2. Equity Rating: When a company floats equity shares then the rating is called equity rating.
3. Preference Share Rating: A company issues preference share, it is called preference share rating.

4. Commercial Paper Rating: There is a type of short term credit. Commercial paper is issued by companies, financial companies, commercial banks, financial institutions; it is called commercial paper rating.
5. Borrowing Rating: When the borrowers are rated by credit rating agencies, it is called borrowing rating.
6. Individual Rating: When an individual is rated' it is called individual rating.
7. Structural Obligation: When the credit is provided on the basis of assets and it is rated then it is called structural obligation.
8. Sovereign Rating: It is the rating of the country. A country has to borrow internally as well as externally.

The rating services in the international markets are generally classified into two road categories as given under:

1. Shadow acing.
2. Formal Rating

The basic difference between the two is that the shadow rating is an indicative rating and suggests if it would be beneficial to go for a formal rating.

**Shadow Rating**
The issuer will not disclose the rating to the public.
The firm can either independently or with the help of its investment banker, assesses its shadow rating by proceeding, as given under:

a. Collection of relevant information, financial ratios used by the rating agencies can be computed.
b. Identification of companies with similar projects and their financial ratings.
c. Assessing the management quality.
d. Weightage to those factors affecting the performance of the company for identification of the strengths and limitations of the firm.
e. Using the ratings of the industry averages.
f. The rating should preferably be in the form of a range and not as a specific rating.

**Formal Rating**
The issuer does Lot announce the rating assigned in formal rating to the public.
The process of rating under this type of credit rating is more detailed than the shadow rating process, since there is a need for more disclosures, and sometimes even plant visits may be involved in it. Formal rating involves monitoring and there will be annual fee for such ratings. There will also be annual meetings.

The formal ratings require the following information by a rating agency:

1. Financial Data
2. Financial Projections
3. Financial support
4. Market Position
5. Management
6. Business Environment

Other types of credit ratings arc as given under:

1. Security Rating deals with debt/Bond Rating and Equity Rating.
2. Individual/Borrowing Rating is concerned with a borrower to whom a loan/credit facility may be sanctioned.
3. Sovereign Rating is concerned with the rating of a country as to its credit worthiness, probability of default etc.

**Credit Rating in India**

The concept of credit rating has been discussed and debated in our country in recent years. The first credit rating agency namely Credit Rating and Information Services of India Ltd. (CRISIL) was set up in 1987 in India. There has been a rapid growth of credit rating agencies in recent years. The major players in the Indian market, apart from CRISIL include Investment Information and Credit Rating Agency of India Ltd. (ICRA), promoted by Industrial Development Bank of India (IDBI) in 1991 and Credit Analysis and Research Ltd. (CARE), promoted by Industrial Finance Corporation-of India (MCI) in 1994. Duff and Phelps has tied up with two Indian NBFCs to set up Duff and Phelps Credit Rating India (P) Ltd. in 1996.

1. Fixed Deposit Rating sign can be seen from the following table:

**Table 3 : CRISIL Fixed Deposit Rating Sign**

| S. No. | Rating | Sign | Rating Particular | Timely Repayment |
|---|---|---|---|---|
| 1 | F Triple-A | FAAA | Highest Safety | Full guarantee |
| 2 | F Double-A | FAA | High safety | Guarantee if conditions are favourable |
| 3 | F Single-A | FA | Adequate safety | No guarantee |
| 4 | F Single-B | FB | Inadequate safety | No guarantee |
| 5 | F Single-B | FC | High Risk | No guarantee |

2. **Investment Information and Credit Rating Agency of India Ltd. (ICRA) :** This agency Was set up in 1991. This agency undertakes rating of the short term, medium term and long term credit instruments. This agency is the most experienced credit rating agency. This agency undertakes the rating of securities relating to commercial banks, financial companies, non-financial companies, public undertakings, municipal corporations etc. It also rates the equity shares in case of urgency. This agency also provides consultative services and provides information relating to commercial, financial, managerial and environmental risks to the public and makes its work more reliable.
   **ICRA Credit Rating Sign:** This agency undertakes credit of the long term, short term and medium term loan. The highest security for the long term credit rating is denoted by LAAA, high rating by LAA and less security by LBB and for the defaulter by LD.
   In case of medium terns credit rating for the highest rating MAA + , inadequate safety by MB + is granted.
   In case of short term credit the ratings are Al for the highest safety, A2 for higher safety and less safety by A4-given by the agency.
3. **Credit Analysis and Research Ltd. (CARE):** The Credit Analysis and Research Lid. (CARE) was set tip by IDBI Bank and companies providing financial services in 1993. The main function of this agency is to conduct research on equity shares and exchange of information along with credit rating. This agency undertakes the long term, medium term and short term credit rating work Shot term credit with highest payment capacity is rated by PR-1, strong payment capacity by PR-2, adequate payment capacity by PR- 3 and minimum payment capacity, by PR-4. The highest rating by CARE-AAA, adequate safety by CARE-BBB and defective payment by CARE-C for long term credit is provided by this credit rating agency.
4. ONIDA Individual Credit Rating Agency (ONICRA) : This agency has been sponsored by ONIDA. It provides individual credit rating. It evaluates the risk in individual financial transactions. The agency also collects information for consumer goods rating.

**Recent Measures to Reform Rating Process**

There are several defects or disadvantages of credit rating. Stock Exchange Board of India (SEBI) has announced the following measures to improve or make effective the rating process:

1. Disclosure of unaccepted ratings to investors has been made compulsory.

2. It has been made mandatory to obtain dual ratings from different recognised agencies for all public and right issues of debt instruments greater than or equal to Rs. 100 crore. Disclosure and investor protection guidelines have been amended.
3. Rating agencies have been debarred from rating debt instruments of their promoter institutions.
4. Restrictions have been imposed on rating a debt instrument of a corporate firm if it has any Common director with the rating agency's promoter institution.

Indian credit rating agencies are highly uncomfortable with the last two restrictions as these restrict the sphere of their business operation because their promoters are largest financial institutions in the country. For example, Industrial Credit and Investment Corporation of India (ICICI), Industrial Finance Corporation- of India (IFCI) and. Industrial Development Bank of India (IDBI).

5. Issuer Company has obligation to disclose all the ratings it has got during the previous three years for any of its listed securities.
6. Credit Rating Agencies (CRAs) have to carry out periodic reviews of the ratings given during the life-time of the rated instrument.
7. SEBI has announced a number of measures to see that corporate provide correct and adequate information to Credit Rating Agencies (CRAs).

Credit rating agencies in India can be seen from the following table:

**Table: Credit Rating Agencies in India**

| S.No | Name of Agency | Ownership | Principal Rating Areas |
|---|---|---|---|
| 1 | Credit Rating and Information Services of India Ltd., 1987 | ICICI | Debt Instruments |
| 2 | Investment Information & Credit Rating Agency Of India Ltd., 1991 | IDB1 | Securitised Assets |
| 3 | Credit Analysis and Research Ltd., 1994 | IFCI | Debt Instruments |
| 4 | Duff and Phelps Credit Rating of India (P) Ltd., 1996 | Duff & Phelps Corporation | Debt Instruments |

The CRISIL rated the first bank in India 1992. The-ratings methodology of banks and financial institutions is essentially based on CRAMEL Approach (Capital Adequacy, Resources; Asset Quality, Management Evaluation, Earnings and Liquidity). The various credit rating agencies working in India are described as given under:

1. Credit Rating and Information Services of India Ltd. (CRISIL): This agency was set up in 1987 by sonic financial institutions like Kra, UTI, GIC and LIC of India. This is the first credit rating agency in India. Although Asian Development Bank had done for the first time the work of credit rating in India. But the CRISIL has developed the new methodology of credit rating with reference to financial, monetary and regulatory system under Indian financial system. It has used commercial paper as an instrument of credit in 1989 and bank as an instrument of credit in 1992.

This agency provides the guidelines to investors relating to security or credit instrument available in which the interest and principal are safe and there will be timely payment. This concept has been more developed among corporations, commercial banks, merchant bank, stock brokers and regulatory authorities. These institutions have recognised the creditor.

This agency has rated fixed deposit, commercial paper, bonds, equity and preference shares, real estate project, short term credit etc. Whenever CRISIL takes the rating of a company's securities, the following action is taken:

1. Acceptance of application for rating.

2. Necessary contract.
3. To assign the task to specialised personnel.
4. To get the necessary information, data etc. for rating.
5. To study information, analyse them and to solve the doubts etc.
6. To take necessary steps for rating.
7. To get the decision from the rating committee and to inform the company accordingly.

If the company accepts the rating of a credit instrument or security, then the rating can not be changed during the life period of that security. If the position of the company has changed and new information is available, the rating of security can be changed which is clone only by credit rating agency. Company has no right to change the rating of its security.

The rating of security can be changed into high category or low category when investors have attracted the attention of the credit rating agency. Rating has been made compulsory in case of debenture and fixed deposits with the amendment of Company Act. If any company wants to raise capital through debentures or fixed deposits, the company has to publish the results of credit rating of its securities in public interest.

**Credit Rating Sign**

Different signs for rating have been recognised for credit rating by Indian Credit Rating Services. These signs are expressed in different was for different securities. The following table reveals the rating sign:

**Table 2 : CRISIL Debenture Rating Sign**

| S. No. | Rating | Sign | Rating Particular | Timely Repayment |
|---|---|---|---|---|
| 1 | Triple-A | AAA | Highest Safety | Full guarantee |
| 2 | Double-A | AA | High safety | Full guarantee |
| 3 | Single-A | A | Adequate safety | Guarantee if the conditions are favourable |
| 4 | Triple-B | BBB | Moderate safety | As per situation |
| 5 | Double-B | BB | Inadequate safety | No guarantee |
| 6 | Single-B | B | Default | No guarantee |

**Derivative Market—Concept, Benefits and Need**

Liberalization, Privatization and Globalization. (LPG) have become the order of the day. Globalisation has reduced the geographical boundries and the whole of the world has become like a Village. With growing globalization and sophistication of financial markets worldwide, there is an urgent need to prepare our Indian markets for integration with markets abroad. Derivatives play an important role in enabling corporate to manage risks. Derivatives are of recent origin even in developed countries. Currency futures first emerged in the USA in 1972, followed by interest rate future. Stock Index Futurs and Options first emerged only in 1982. Now they have spread rapidly both in developed and developing countries as well. Derivatives have been recognized as the most cost efficient way of hedging risks in certain types of commercial and financial transactions. In such a situation those countries not providing such globally accepted risk-hedging facilities are disadvantaged in present rapidly integrated global economy.

**Concept of Derivatives**

Derivatives are structured products that derive their value from the underlying instrument like stocks, bonds, commodities, etc. They are increasingly used to manage risk. Some of the important derivatives used in risk managements are forwards futures, swaps and options. They are used for hedging. Derivatives are off-balance sheet transactions and they cannot be put on the balance sheet unless the underlying assets are bought and paid for. For example, if an investor buys an option to purchase shares, the balance sheet is unaffected until and unless the shares are bought and paid for.

**Forward Contract :** have existed for centuries but they have following drawbacks :

1. The contract price is not publicly disclosed,
2. The forward contract is not typically tradable,
3. It has to be settled by delivery of the asset on the expiration date.

Futures trading a more efficient way of hedging risk as they are standardized tradable contracts. A futures transaction arises when an investor agrees on a particular date at a predetermined price. Futures are standardized in terms of size, expiration date and all other features. They are traded on specially designed changes in a highly sophisticated, environment of stringent financial safeguards. They are liquid and transparent. The market prices and trading volume are regularly reported.

**Futures and Options** have many similarities and serve similar purposes. Options are contracts giving the holds the right, but not the obligation, to any ("call options") or sell (Tut option") a particular asset at a stated price ("strike price") within a specified period.

Derivatives are used as tools of risk management and are also traded in exchanges, thus facilitating market transactions in developed-countries.

**Need and Importance**
A derivative is a financial contract whose value depends on the value of one or more underlying assets. This comprises of contracts such as forwards, futures, swaps and options whose primary purpose is not to borrow and lend funds but rather to transfer risks associated with fluctuations in asset or liability values.

Derivatives are indispensable tool for finance manager whose primary objective is to manage\reduce the risk in their portfolios.
The uses of derivatives are as given under:

1. Hedging
2. Speculation
3. Investing
4. Arbitrage

Most institutional and individual investors use the derivatives as hedges. Professional investors like financial institutions, banks and, brokerages deal actively in derivatives for investment, speculation and arbitrage.

Future Contracts like options contracts are financial derivatives. Their value is derived from some underlying instrument namely equity shares.

Derivatives Trading in India are needed on account of the following reasons

1. Forward contracts are extensively used for covering currency risk. But there are neither currency futures nor any other financial futures in India.
2. There is no forum for trading in derivatives and market players. Hence there is a growing need for active use of derivatives to manage risks.
3. The Tarapore Committee on Capital Account Convertibility had expressed the view in mid 1997 that "time is ripe for introduction cf futures in currencies and interest rates to facilitate various users to have access to a wide spectrum of cost-effective hedge mechanism".
4. The trading in futures is more transparent and cost efficient than the existing system of forward contracts.

**Benefits**
The L.C. Gupta Committee on Derivative Trading in India has revealed the need of derivatives because of the following benefits:

1. It provides facility of hedging against market risk in the most cost efficient way.
2. Derivatives have many uses for producers and consumers who deal in commodities.
3. Banks, mutual funds and insurance companies find derivatives very useful in managing their portfolio effectively.
4. Manufacturing Companies find it useful for hedging against adverse changes in prices in the future.
5. Globalisation has brought several risks which are salved by the derivatives.
6. Speculators too find these instruments very attractive and they can use in different types of derivatives—simple futures, swaps and options.

**Conclusion**

Financial derivatives in India at this juncture have economic importance and it would boost trading liquidity and market sentiments. The high degree of regulation and other safeguards will be helpful in the emergence of a sound market for derivatives trading in India. With the rapid expansion of Indian economy the large number of investors will seek new instruments to headge their risks.