Unit I : Overview

Meaning of Financial System, Functions and Key elements of the Indian Financial System, Role of the Financial System in the Economy, Reforms in the Financial System.

INDIAN FINANCIAL SYSTEM

The structure of the Indian financial system may be summarized in the following schematic representation. Broadly the Indian financial system may be divided into organized and unorganized segments. The organized market consists of commercial banks, development banks, cooperative banks, post-office savings bank operations, stock markets etc. Unorganised financial market operations consist of hundis, money lending, chit funds etc. They operate mainly in the rural areas. However in the urban areas also unorganized money market activities are quite significant. There is no precise estimate of the size of the unorganized money market. It is generally expected that the relative size of the unorganized money market transactions would decline over time.

Definition of Financial System

"It is a set of institutions instruments and markets which fosters saving and channels them to their most efficient use". **H.R. Machiraju.**

"Financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption". **Van Horne.**

"Financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provides the principal means by which savings are transformed into investments". **Prasanna Chandra.**

Role and Importance of Financial System in Economic Development:

1. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through savinginvestment process. This savings – investment process is called capital formation.

2. It helps to monitor corporate performance.

3. It provides a mechanism for managing uncertainty and controlling risk.

4. It provides a mechanism for the transfer of resources across geographical boundaries.

5. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).

6. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
7. It promotes the process of capital formation.
8. It helps in promoting the process of financial deepening and broadening.

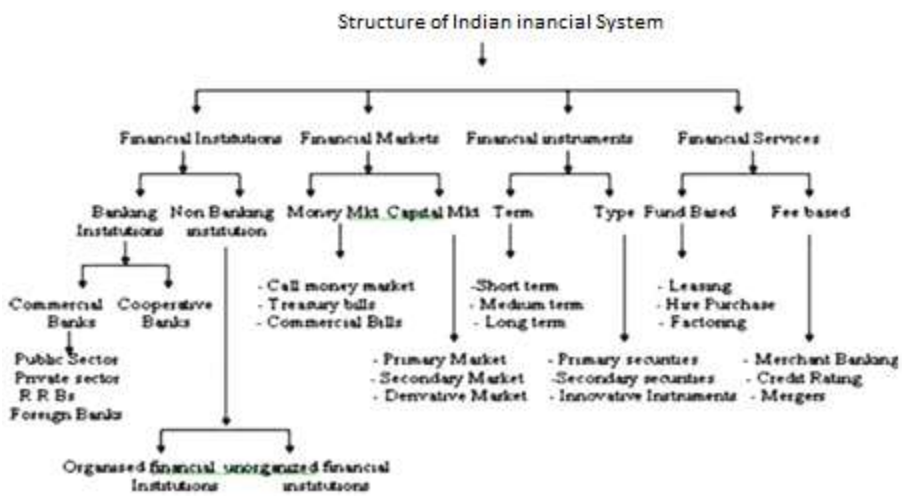
FUNCTIONS OF FINANCIAL SYSTEM: The financial system of a country performs certain valuable functions for the economic growth of that country. The main functions of a financial system may be briefly discussed as below:

1. **Saving function:** An important function of a financial system is to mobilize savings and channelize them into productive activities. It is through financial system the savings are transformed into investments.
2. **Liquidity function**: The most important function of a financial system is to provide money and monetary assets for the production of goods and services. Monetary assets are those assets which can be converted into cash or money easily without loss of value. All activities in a financial system are related to liquidityeither provision of liquidity or trading in liquidity.
3. **Payment function:** The financial system offers a very convenient mode of payment for goods and services. The cheque system and credit card system are the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.
4. **Risk function**: The financial markets provide protection against life, health and income risks. These guarantees are accomplished through the sale of life, health insurance and property insurance policies.
5. **Information function:** A financial system makes available pricerelated information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.
6. **Transfer function:** A financial system provides a mechanism for the transfer of the resources across geographic boundaries.
7. **Reformatory functions:** A financial system undertaking the functions of developing, introducing innovative financial assets/instruments services and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).

8. **Other functions:** It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

Structure of the Indian Financial System. This includes:

1. Financial Institutions
2. Financial Markets
3. Financial Assets
4. Financial Services



Financial Institutions The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilized either directly or indirectly via the Financial Markets.

The main functions of the Financial Institutions are as follows:

- A short term liability can be converted into a long term investment
- It helps in conversion of a risky investment into a riskfree investment
- Also acts as a medium of convenience denomination, which means, it can match a small deposit with large loans and a large deposit with small loans

The best example of a Financial Institution is a Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

The financial institutions can further be divided into two types:

- **Banking Institutions or Depository Institutions –** This includes banks and other credit unions which collect money from the public against interest provided on the deposits made and lend that money to the ones in need
- **NonBanking Institutions or NonDepository Institutions –** Insurance, mutual funds and brokerage companies fall under this category. They cannot ask for monetary deposits but sell financial products to their customers.

Further, Financial Institutions can be classified into three categories:

- **Regulatory –** Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates –** Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates –** Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

1. **Financial Markets** The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.

The financial market can be further divided into four types:

- **Capital Market –** Designed to finance the long term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:
  - **a)** Corporate Securities Market
  - **b)** Government Securities Market
  - **c)** Long Term Loan Market
- **Money Market –** Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for smallterm investments only. It is a wholesale debt market which works on lowrisk and highly liquid instruments. The money market can further be divided into two types:
  - **a)** Organised Money Market
  - **b)** Unorganised Money Market
- **Foreign exchange Market –** One of the most developed markets across the world, the Foreign exchange market, deals with the requirements related to multicurrency. The transfer of funds in this market takes place based on the foreign currency rate.

- **Credit Market –** A market where shortterm and longterm loans are granted to individuals or Organisations by various banks and Financial and NonFinancial Institutions is called Credit Market

2. **Financial Assets** The products which are traded in the Financial Markets are called Financial Assets. Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.

   Some important Financial Assets are

   a) **Call Money –** When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.
   b) **Notice Money –** When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
   c) **Term Money –** When the maturity period of a deposit is beyond 14 days, it is called term money.
   d) **Treasury Bills –** Also known as TBills, these are Government bonds or debt securities with maturity of less than a year. Buying a TBill means lending money to the Government.
   e) **Certificate of Deposits –** It is a dematerialised form (Electronically generated) for funds deposited in the bank for a specific period of time.
   f) **Commercial Paper –** It is an unsecured shortterm debt instrument issued by corporations.

3. **Financial Services** Services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include:

a) **Banking Services –** Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.
b) **Insurance Services –** Services like issuing of insurance, selling policies, insurance undertaking and brokerages, etc. are all a part of the Insurance services
c) **Investment Services –** It mostly includes asset management
d) **Foreign Exchange Services –** Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services

The main aim of the financial services is to assist a person with selling, borrowing or purchasing securities, allowing payments and settlements and lending and investing.

Weaknesses Of Indian Financial System

Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1. **Lack of coordination among financial institutions:** There are a large number of financial intermediaries. Most of the financial institutions are owned by the government. At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of coordination in the working of these institutions.
2. **Dominance of development banks in industrial finance**: The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.
3. **Inactive and erratic capital market**: In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and enactive. Investors too prefer investments in physical assets to investments in financial assets.
4. **Unhealthy financial practices**: The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse.
5. **Monopolistic market structures**: In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.

6. **Other factors:** Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system. Examples are:
   a) Banks and Financial Institutions have high level of NPA.
   b) Government burdened with high level of domestic debt.
   c) Cooperative banks are labeled with scams.
   d) Investors confidence reduced in the public sector undertaking etc
   e) Financial illiteracy.

In the recent past, the most notable aspect of Indian economy is its financial system. Perhaps no system in the world has changed so much as that of our financial system. Indian financial system undergoing fast development and hence not matured like that of developed countries. The government should take reasonable reforms to mould our financial system as healthy one.

ROLE OF THE FINANCIAL SYSTEM IN THE ECONOMY

The financial system plays a crucial role in any economy by facilitating the allocation of resources, managing risks, and enabling economic growth. Here's a breakdown of its key functions and the reforms often undertaken to enhance its efficiency and stability:

1. Resource Allocation: The financial system channels funds from savers (households and businesses) to borrowers (individuals, businesses, and governments) through various financial instruments like loans, bonds, and stocks. This allocation of capital is essential for investment in productive activities, such as starting businesses, funding infrastructure projects, and supporting innovation.

2. Risk Management: Financial institutions, such as banks and insurance companies, provide mechanisms to manage and mitigate financial risks. They offer services like deposit insurance, which protects depositors from bank failures, and insurance products that safeguard against unforeseen events such as accidents, natural disasters, or illness.

3. Facilitating Transactions: The financial system provides the infrastructure for efficient payment and settlement of transactions. This includes mechanisms like electronic funds transfers, credit and debit card transactions, and online banking platforms, which facilitate the smooth flow of funds between individuals, businesses, and government entities.

4. Price Discovery: Financial markets, such as stock exchanges and commodity markets, play a vital role in determining asset prices based on supply and demand dynamics. These prices provide valuable information to investors, businesses, and policymakers, guiding their decision making processes and resource allocation strategies.

5. Intermediation: Financial intermediaries, like banks and investment funds, bridge the gap between savers and borrowers by pooling funds from multiple sources and investing them in various assets. This intermediation function reduces transaction costs, improves liquidity, and enhances the efficiency of capital allocation.

REFORMS IN THE FINANCIAL SYSTEM

Reforms in the financial system are often undertaken to address weaknesses, enhance resilience, and promote stability. Some common reforms include:

1. **Regulatory Oversight:** Strengthening regulatory frameworks and supervision to ensure the stability and integrity of the financial system. This may involve imposing stricter capital requirements, enhancing risk management standards, and implementing measures to prevent excessive risktaking by financial institutions.
2. **Enhanced Transparency:** Improving transparency and disclosure standards to provide investors and stakeholders with better information about the financial health and performance of institutions and markets. This can help reduce asymmetric information and improve market efficiency.
3. **Risk Management Measures:** Implementing measures to identify, assess, and mitigate systemic risks within the financial system. This may include stress testing of financial institutions, establishing resolution frameworks for troubled firms, and enhancing coordination among regulatory authorities.
4. **Promoting Financial Inclusion:** Expanding access to financial services and products for underserved populations, such as lowincome individuals and small businesses. This can be achieved through initiatives like microfinance programs, mobile banking services, and targeted financial education efforts.
5. **Technology and Innovation:** Embracing technological advancements to enhance the efficiency, accessibility, and resilience of the financial system. This may involve the adoption of fin-tech solutions, block chain technology, and digital payment platforms to streamline processes and reduce costs.

Overall, reforms in the financial system are aimed at fostering a stable, efficient, and inclusive financial sector that supports sustainable economic growth and development.

Unit II :

Money Market

Money Market : Composition, Functions and Instruments. Development Banks, Banking and NonBanking Financial Institutions

MONEY MARKET OVERVIEW

Definition:

The money market is a sector of the financial market where financial instruments with high liquidity and short maturities are traded. It is used by participants as a means for borrowing and lending in the short term, typically for periods ranging from overnight to one year.

Key Characteristics:

1. **Liquidity:** Money market instruments are highly liquid, meaning they can be quickly converted into cash with minimal loss of value.
2. **Short Maturities:** The instruments traded in the money market have short maturities, often less than one year.
3. **Low Risk:** Due to the short duration of these instruments, the risk is generally lower compared to long-term securities.
4. **High Denomination:** Transactions often involve large amounts of money, making them more suitable for institutional investors.

Common Money Market Instruments:

1. **Treasury Bills (T-Bills):** Short-term government securities with maturities ranging from a few days to one year. They are sold at a discount and redeemed at face value.
2. **Commercial Paper:** Unsecured, short-term debt instruments issued by corporations. They are typically used for financing payroll, accounts payable, and inventories.
3. **Certificates of Deposit (CDs):** Time deposits offered by banks with specific maturity dates and interest rates. They can be negotiable or non-negotiable.
4. **Repurchase Agreements (Repos):** Short-term borrowing agreements where a party sells a security and agrees to repurchase it at a higher price at a later date.
5. **Bankers' Acceptances:** Short-term credit investments created by a non-financial firm and guaranteed by a bank. They are often used in international trade.

Participants in the Money Market:

1. **Central Banks:** Regulate the money supply and interest rates. They often use money market operations to implement monetary policy.
2. **Commercial Banks**: Participate by borrowing and lending funds to manage their liquidity.
3. **Corporations:** Issue commercial paper to meet short-term funding needs.
4. **Mutual Funds:** Offer money market funds to investors seeking a safe place to park their cash with some return.
5. **Government Entities:** Issue T-bills to finance short-term government needs.

Importance of the Money Market:

1. **Liquidity Management:** Provides a platform for managing liquidity, allowing institutions to borrow or lend funds quickly.
2. **Monetary Policy Implementation**: Central banks use money market operations to influence interest rates and control money supply.
3. **Financing Short-term Needs:** Enables corporations and governments to finance their short-term cash flow requirements.
4. **Safety and Stability:** Offers a safe investment avenue for investors looking to preserve capital and maintain liquidity.

Risks in the Money Market:

1. **Credit Risk:** The risk that the issuer of a financial instrument may default.
2. **Interest Rate Risk:** The risk of changes in interest rates affecting the value of instruments.
3. **Liquidity Risk:** The risk that an instrument cannot be sold quickly without significant loss of value.
4. **Market Risk:** The risk of adverse market conditions affecting the prices of money market instruments.

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Money Market:

Composition: The money market comprises various financial institutions and instruments that facilitate shortterm borrowing and lending of funds. Participants include banks, corporations, government entities, and institutional investors.

Functions:

- **Liquidity Management:** The money market provides a platform for entities to manage their shortterm liquidity needs efficiently. Participants can easily access funds or invest surplus funds for short durations.
- **Interest Rate Determination:** It serves as a crucial mechanism for the determination of shortterm interest rates, influencing borrowing and lending rates across the broader financial system.
- **Facilitating Monetary Policy:** Central banks often use the money market as a tool for implementing monetary policy objectives. They conduct open market operations, such as buying or selling government securities, to regulate the money supply and influence interest rates.

Instruments:

- **Treasury Bills (TBills):** Shortterm debt securities issued by governments to raise funds. They typically have maturities ranging from a few days to one year and are considered one of the safest money market instruments.
- **Commercial Paper (CP):** Unsecured promissory notes issued by corporations to raise shortterm funds. They typically have maturities ranging from one to 270 days and are often used to finance working capital needs.
- **Certificates of Deposit (CDs):** Time deposits offered by banks to customers, usually with fixed terms ranging from a few weeks to several months. Investors earn interest on CDs, and they can be traded in the secondary market before maturity.
- **Repurchase Agreements (Repos):** Shortterm agreements where one party sells securities to another party with a promise to repurchase them at a specified price on a future date. Repos are commonly used for shortterm funding by financial institutions and are backed by collateral.
- **Banker's Acceptances (BAs):** Shortterm credit instruments issued by banks on behalf of customers, typically used in international trade transactions. BAs represent a bank's unconditional promise to pay the holder a specified amount on a future date.

DEVELOPMENT BANK

Development banks are financial institutions that are primarily focused on providing longterm financing for projects and initiatives that contribute to the economic development and growth of a country or region. These institutions often operate at national, regional, or international levels and are typically owned or supported by governments, multilateral organizations, or a combination of both. Here's a deeper look at development banks:

Development banks are specialized financial institutions that primarily focus on providing longterm financing for economic development projects. They typically operate at national or regional levels and are often owned or supported by governments, multilateral organizations, or a combination of both.

Functions:

- **Project Financing:** Development banks provide financing for infrastructure projects, industrial development, agriculture, and other sectors critical for economic growth.

- **Risk Mitigation:** They often assume higher risks than commercial banks by providing funding to projects that may not be financially viable in the short term but have significant longterm developmental impacts.
- **Policy Support:** Development banks may offer technical assistance and policy advice to governments to support the implementation of development strategies and reforms.

Role of Development Banks

- **Longterm Financing:** Development banks specialize in offering financing for projects that require significant investment and have long gestation periods. These projects may include infrastructure development (such as roads, bridges, ports, and airports), industrial expansion, energy projects, agriculture, education, healthcare, and housing.
- **Promoting Economic Development**: The primary objective of development banks is to promote economic development and alleviate poverty by investing in projects that stimulate growth, create employment opportunities, enhance productivity, and improve living standards. They often prioritize sectors and regions that are underserved by commercial banks or face financing constraints.
- **Risk Mitigation:** Development banks frequently assume higher risks than commercial banks by providing financing to projects that may not be considered financially viable in the short term but have significant longterm developmental impacts. They may offer concessional terms, longer repayment periods, and lower interest rates to support projects with high social or environmental benefits.
- **Technical Assistance and Policy Support:** In addition to providing financial support, development banks often offer technical assistance, capacity building, and policy advice to governments and project stakeholders. They may help governments design and implement development strategies, regulatory frameworks, and institutional reforms to promote sustainable economic growth and inclusive development.
- **Mobilizing Resources:** Development banks mobilize financial resources from various domestic and international sources, including government appropriations, capital markets, multilateral development agencies, and bilateral donors. They leverage their capital base to attract additional financing and coin vest with private sector partners to maximize developmental impact.

- **Collaboration and Partnerships:** Development banks collaborate with a wide range of stakeholders, including governments, private sector entities, civil society organizations, and international institutions, to identify priority areas for investment, mobilize resources, and implement projects effectively. They often work in partnership with other financial institutions and development agencies to leverage expertise, resources, and networks.

Examples of Development Banks:

- **World Bank Group:** The World Bank Group consists of five institutions, including the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), which provide financial and technical assistance to developing countries.
- **Asian Development Bank (ADB):** A regional development bank focused on promoting economic and social development in Asia and the Pacific through investment in infrastructure, education, healthcare, and other sectors.
- **African Development Bank (AfDB):** A regional development bank dedicated to promoting economic development and social progress in Africa through investment in infrastructure, agriculture, energy, and other key sectors.
- **European Investment Bank (EIB):** The European Union's bank, which provides financing and expertise for projects that contribute to EU policy objectives, including infrastructure, innovation, and environmental sustainability.

In summary, development banks play a crucial role in supporting sustainable development by providing longterm financing, technical assistance, and policy support for projects that promote economic growth, social inclusion, and environmental sustainability. They serve as catalysts for positive change, driving investment in critical sectors and helping countries achieve their development goals.

Non-Banking Financial Institutions

NBFIs are financial intermediaries that provide financial services but do not have a full banking license. They include entities such as insurance companies, mutual funds, leasing companies, finance companies, and pension funds. NBFIs play important roles in mobilizing savings, providing credit, managing risks, and facilitating investment, complementing the services offered by traditional banks.

In summary, development banks focus on longterm financing for economic development, while banking and nonbanking financial institutions provide a wide range of financial services, catering to different segments of the economy and meeting diverse financial needs.

NonBanking Financial Institutions (NBFIs) are financial intermediaries that provide a wide range of financial services but do not hold a full banking license. These institutions play significant roles in the financial system by catering to specific needs that may not be adequately addressed by traditional banks. Here's a closer look at NBFIs:

1. **Diverse Financial Services:** NBFIs offer a variety of financial products and services, including:
   - **Investment Services:** Such as brokerage firms and investment banks that facilitate the buying and selling of securities (stocks, bonds, derivatives) on behalf of clients.
   - **Insurance Companies:** Which provide various types of insurance coverage, including life insurance, health insurance, property and casualty insurance, and annuities.
   - **Mutual Funds and Asset Management Companies:** Which pool funds from investors to invest in a diversified portfolio of securities, such as stocks, bonds, and money market instruments.
   - **Leasing Companies:** Which provide equipment leasing and financing solutions to businesses and individuals.
   - **Finance Companies:** Which offer consumer and commercial lending, including auto loans, personal loans, and equipment financing, often specializing in specific sectors or customer segments.
2. **Specialized Expertise:** NBFIs often possess specialized expertise in specific areas of finance, allowing them to tailor their products and services to meet the unique needs of their clients. For example, investment banks may provide advisory services for mergers and acquisitions, while insurance companies develop customized insurance solutions for different industries and risk profiles.
3. **Risk Management and Diversification:** NBFIs contribute to the diversification of risk within the financial system by offering alternative investment opportunities and risk management tools. Investors can access a broader range of asset classes and strategies through mtual funds, hedge funds, and other investment vehicles offered by NBFIs, thereby spreading their risk across different markets and instruments.

4. **Complementary Role to Banks:** While NBFIs complement traditional banks by providing additional avenues for financing and investment, they also compete with banks in certain segments of the financial services market. For example, finance companies may compete with banks in providing consumer loans, while mutual funds may compete with banks' wealth management services.
5. **Regulatory Oversight:** Although NBFIs do not engage in traditional banking activities such as accepting deposits, they are subject to regulation and supervision by relevant regulatory authorities to ensure financial stability, consumer protection, and market integrity. Regulatory requirements may vary depending on the type of NBFI and the jurisdiction in which it operates.

Examples of NBFIs:

- **Insurance Companies:** Such as MetLife, Prudential Financial, and AIA Group.
- **Mutual Funds:** Such as Vanguard, Fidelity Investments, and BlackRock.
- **Brokerage Firms:** Such as Charles Schwab, TD Ameritrade, and ETRADE.
- **Leasing Companies:** Such as GE Capital, CIT Group, and DLL (De Lage Landen).

In summary, NonBanking Financial Institutions play vital roles in the financial system by providing diverse financial services, specialized expertise, and alternative investment opportunities. They contribute to financial innovation, risk management, and market efficiency, helping to meet the evolving needs of individuals, businesses, and investors in a dynamic global economy.

Unit III : Capital Market

Capital Market : Functions, Organisation & Instruments. Primary Market : Issues, Book building, Green Shoe Option, IPO's and FPO's. Secondary Market : Functions and Organisation. Concept of Derivative and Debt Market in India.

CAPITAL MARKET: FUNCTIONS, ORGANISATION & INSTRUMENTS

Capital Market Overview:

The capital market is a financial market where long-term debt or equity-backed securities are bought and sold. It plays a crucial role in the economy by channeling surplus funds from savers to entities that require capital for productive uses.

Functions:

1. **Mobilization of Savings:** Capital markets facilitate the transfer of individual savings into investments, contributing to economic growth.
2. **Capital Formation**: They help in raising long-term capital for businesses and governments, supporting expansion and development.
3. **Liquidity Provision:** By enabling the buying and selling of securities, capital markets provide liquidity, allowing investors to convert their investments into cash.
4. **Risk Management:** They offer various financial instruments that help in hedging against risks.
5. **Pricing of Securities:** The capital market aids in the determination of security prices through supply and demand dynamics.
6. **Efficient Allocation of Resources**: Capital markets allocate funds to projects with the highest returns, ensuring efficient utilization of resources.

ORGANISATION:

- **Primary Market:** This is where new securities are issued and sold for the first time.
- **Secondary Market:** This is where existing securities are traded among investors.

INSTRUMENTS:

1. **Equities:** Shares of ownership in a company.
2. **Debt Instruments:** Bonds, debentures, and other forms of borrowing.
3. **Derivatives:** Financial contracts whose value is derived from underlying assets.

PRIMARY MARKET

Functions:

- Facilitates the issuance of new securities.
- Helps companies raise capital for expansion and growth.
- Allows governments to fund infrastructural projects.

Key Concepts:

1. Issues:

- **Public Issues:** Securities offered to the general public.
- **Private Placement:** Securities offered to a select group of investors.

2. Book Building:

- A process used during an IPO where the price of the securities is determined based on investor demand.
- Institutional investors bid for shares before the final price is set.

3. Green Shoe Option:

- An option that allows the underwriters to sell additional shares if the demand exceeds expectations.
- Helps stabilize the share price post-IPO.

4. IPO (Initial Public Offering):

- The first time a company offers its shares to the public.
- Helps companies raise capital and gain market exposure.

5. FPO (Follow-on Public Offering):

- Additional issuance of shares by a company after an IPO.
- Used to raise additional capital from the public.

SECONDARY MARKET

Functions:

- Provides liquidity and marketability to existing securities.
- Helps in price discovery through continuous trading.
- Enables investors to buy and sell securities, ensuring the efficient allocation of resources.

Organisation:

- Stock Exchanges: Platforms where securities are traded, e.g., NYSE, NASDAQ, BSE, NSE.
- OTC Market: Over-the-counter markets where securities not listed on formal exchanges are traded.

CONCEPT OF DERIVATIVE AND DEBT MARKET IN INDIA

Derivative Market:

- Definition: Financial instruments whose value is derived from underlying assets like stocks, bonds, commodities, or currencies.

- Types:

- Futures: Contracts to buy or sell an asset at a future date at a predetermined price.
- Options: Contracts that give the right, but not the obligation, to buy or sell an asset at a predetermined price.
- Swaps: Contracts to exchange cash flows or other financial instruments between parties.
- Functions: Risk management, price discovery, and leveraging investment.

Debt Market:

- Definition: A market where fixed-income securities like bonds and debentures are issued and traded.

Types of Debt Instruments:

- **Government Securities:** Bonds issued by the government.
- **Corporate Bonds:** Bonds issued by companies.
- **Municipal Bonds:** Bonds issued by local governments.
- **Functions:** Raising capital for governments and corporations, providing a low-risk investment option, and facilitating monetary policy implementation.

Debt Market in India:

- Comprises government and corporate bonds.
- Key players include the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), and various financial institutions.
- Platforms like NSE and BSE offer trading in debt instruments.

Unit IV : Financial Services

Investments and Merchant Banks, Depository and Custodians, Credit Rating Agencies, Factoring and Forfeiting, Lease, Hire purchase, Housing Finance, Micro Finance.

INVESTMENTS AND FINANCIAL SERVICES

Understanding various financial services and institutions is crucial for both businesses and individuals. Here is an overview of investments and several key financial services, including merchant banks, depositories and custodians, credit rating agencies, factoring and forfeiting, leasing, hire purchase, housing finance, and microfinance.

INVESTMENTS

Definition:

Investments involve allocating money into various financial instruments or assets with the expectation of generating income or profit.

Types of Investments:

1. **Stocks:** Equity investments representing ownership in a company.
2. **Bonds:** Debt securities issued by corporations or governments to raise capital.
3. **Mutual Funds:** Investment vehicles that pool money from multiple investors to buy a diversified portfolio of stocks, bonds, or other securities.
4. **Real Estate:** Investment in property for rental income or capital appreciation.
5. **Commodities:** Investments in physical goods like gold, oil, or agricultural products.
6. **ETFs (Exchange-Traded Funds**): Funds that track indexes and trade like stocks on exchanges.
7. **Derivatives:** Financial contracts whose value is derived from underlying assets such as stocks, bonds, or commodities.

Functions:

- **Wealth Accumulation:** Building wealth over time through capital appreciation and income generation.
- **Risk Management:** Diversifying portfolios to manage and mitigate financial risks.
- **Liquidity:** Providing liquidity to investors who can buy and sell investments as needed.
- **Economic Growth:** Channeling funds into productive uses, thereby contributing to economic development.

MERCHANT BANKS

Definition:

Merchant banks are financial institutions that provide a wide range of services, including underwriting, loan services, financial advisory, and fundraising for large corporations and high-net-worth individuals.

Functions:

- **Underwriting:** Assisting companies in raising capital through stock issuance.
- **Advisory Services**: Providing strategic advice on mergers, acquisitions, and other corporate finance matters.
- **Portfolio Management:** Managing investments on behalf of clients.
- **Corporate Restructuring:** Advising on organizational restructuring and turnaround strategies.

DEPOSITORIES AND CUSTODIANS

Depository:

- **Definition:** An entity that holds and manages securities in electronic form, facilitating their transfer and settlement.
- **Functions:** Ensuring the safekeeping of securities, managing corporate actions, and facilitating trade settlements.
- **Examples:** Central Depository Services Limited (CDSL), National Securities Depository Limited (NSDL).

Custodians:

- **Definition:** Financial institutions that hold and safeguard a firm's or individual's securities.
- **Functions:** Managing securities transactions, providing reporting services, and ensuring the safety of assets.

CREDIT RATING AGENCIES

Definition:

Credit rating agencies assess the creditworthiness of issuers of debt securities.

Functions:

- **Rating Bonds**: Providing ratings that indicate the likelihood of default.
- **Financial Assessment:** Evaluating the financial health of companies and governments.
- **Impact:** Ratings influence interest rates and investor perceptions.

Examples: CRISIL, ICRA, CARE, Moody's, S&P.

FACTORING AND FORFEITING

Factoring:

- **Definition:** A financial transaction where a business sells its accounts receivable to a third party (factor) at a discount.
- **Functions:** Provides immediate cash flow, reduces credit risk, and manages accounts receivable.

Forfeiting:

- **Definition:** The purchase of receivables from exporters by a forfeiter who assumes all risks.
- **Functions:** Provides exporters with immediate cash, removes the need for credit checks on buyers, and mitigates risks associated with international trade.

LEASE

Definition:

A lease is a contractual arrangement where a lessee uses an asset owned by the lessor in exchange for periodic payments.

Types:

- **Operating Lease:** Short-term, cancellable leases where the lessor retains ownership.
- **Finance Lease:** Long-term, non-cancellable leases transferring most ownership risks and rewards to the lessee.

Functions: Provides businesses with access to assets without large capital outlay and offers tax benefits.

HIRE PURCHASE

Definition:

A system of purchasing goods through an initial down payment followed by periodic installments.

Functions: Facilitates the acquisition of assets, spreads the cost over time, and provides a financing option for individuals and businesses without immediate funds.

HOUSING FINANCE

Definition:

Financial services provided to individuals and developers for residential housing needs.

Functions:

- **Home Loans:** Providing mortgages for purchasing or constructing homes.
- **Loan Against Property:** Loans secured by existing residential properties.
- **Refinancing:** Offering better terms or lower interest rates for existing home loans.

Key Players: Banks, housing finance companies, and government schemes (e.g., Pradhan Mantri Awas Yojana).

MICROFINANCE

Definition:

Financial services targeted at low-income individuals or groups who lack access to traditional banking services.

Functions:

- **Microcredit:** Small loans for entrepreneurial activities and personal use.
- **Savings Accounts:** Providing secure saving options for the poor.
- **Insurance:** Offering micro-insurance products for health, life, and assets.
- **Impact:** Empowers low-income individuals, supports small businesses, and promotes financial inclusion.

Key Institutions: Microfinance institutions (MFIs), self-help groups (SHGs), and non-governmental organizations (NGOs).