FINANCIAL MARKETS

AND

SERVICES

B.Com

VI SEMESTER

SPECIALIZATION – FINANCE

(CUCBCSS 2014 Admn.Onwards)

UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

Calicut University.P.O., 673635

343A

UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

Study Material

VI SEMESTER

(Specialization – Finance)

2014 Admn. Onwards

FINANCIAL MARKETS AND SERVICES

Prepared by:

Smt.U.SREEVIDYA

Assistant Professor

PTM Government College

Perinthalmanna

Settings & Lay Out by: SDE, Computer Cell

CONTENTS

CHAPTER-1

Financial Markets –An Overview

Introduction

Financial managers and investors don’t operate in a vacuum; they make decisions within a large and complex financial environment. This environment includes financial markets and institutions, tax and regulatory policies, and the state of the economy. The environment both determines the available financial alternatives and affects the outcomes of various decisions. Thus, it is crucial that investors and financial managers have a good understanding of the environment in which they operate. History shows that a strong financial system is a necessary ingredient for a growing and prosperous economy. Companies raising capital to finance capital expenditures as well as investors saving to accumulate funds for future use require well functioning financial markets and institutions.

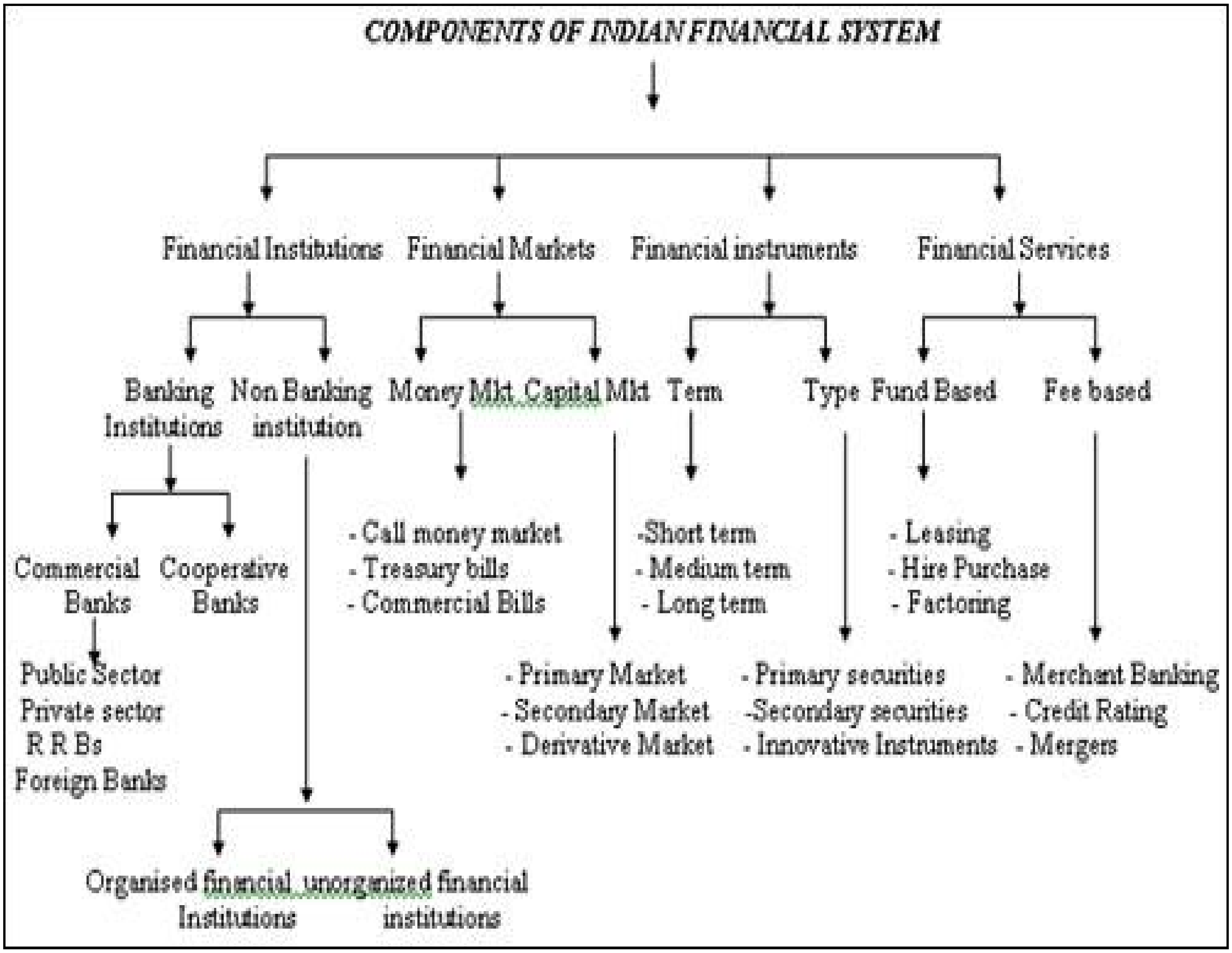
A **financial system** (within the scope of finance) is a system that allows the exchange of funds between lenders, investors, and borrowers. Financial systems operate at national, global, and firm-specific levels. They consist of complex, closely related services, markets, and institutions intended to provide an efficient and regular linkage between investors and depositors. Money, credit, and finance are used as media of exchange in financial systems. They serve as a medium of known value for which goods and services can be exchanged as an alternative to bartering. A modern financial system may include banks (operated by the government or private sector), financial markets, financial instruments, and financial services. Financial systems allow funds to be allocated, invested, or moved between economic sectors. They enable individuals and companies to share the associated risks.

The formal financial system consists of four **components**:

1. Financial institutions,
2. Financial markets,
3. Financial instruments and
4. Financial services.

The financial system acts as a connecting link between savers of money and users of money and thereby promotes faster economic and industrial growth. Thus financial system may be defined as "a set of markets and institutions to facilitate the exchange of assets and risks." Efficient functioning of the financial system enables proper flow of funds from investors to productive activities which in turn facilitates investment.

Components of Indian Financial System



Financial Intermediaries

A financial intermediary is an institution which connects the deficit and the surplus. The best example of an intermediary can be a **bank** which transforms the bank deposits to bank loans. The role of financial intermediary is to channel funds from people who have extra inflow of money i.e., the savers to those who do not have enough money to fulfill the needs or to carry out the basic activities i.e. the borrowers.

Functions of Financial Intermediaries

Functions of Financial Intermediary are basically classified in three parts which are as follows:

- **Maturity transformation –** Deals with the conversion of short-term liabilities to long term assets.
- **Risk transformation** – Conversion of risky investments into relatively risk-free ones.
- **Convenience denomination** – Way of making the unmatched matching which is matching small deposits with large loans and large deposits with small loans.

Financial Intermediaries are classified into two types namely, Depository and Non-Depository Institutions.

Financial Assets

These assests are used for production or consumption or further creation of assests. The financial assests are the claims of money and perfoms some functions of money. They have high degree of liquidity but not as liquid as money has. The financial assest is different from physical assests. Financial assests are useful for further production of goods or for earning income. The physical assests are not useful for further production or for earning income.

Classification Of Financial Assets.

Financial assets can be classified in different ways.

- Primary assets- those are the financial claim against real sector units created by themselves for raising funds to finance their deficient spending. They are the ultimate borrowers. Eg bills, bonds, equities etc are primary assets.
- Secondary assets- these are financial claims issued by financial institution against themselves to raise funds from the public. These assests are the obligations of financial institution. Eg bank deposits, life insurance policies, UTI units etc are secondary assests.

Another classification is

- Marketable assests-These are the financial assests which can be transferred from person to person without difficulty. It consist of shares, government securities, bonds, mutual funds units, UTI units, bearer debentures etc.

- Non marketable assests- These are financial assests which cannot be transferred easily. It consists of bank deposits, provident funds, LIC schemes, company deposits ,Post office certificates.

Another classification is

- Cash assests- Money assests consist of coins and currency notes and created money.reserve bank has the sole authority to issue currencies.
- Debt asset- different type of organization issues debt assets for raising their debt capital.There is a fixed time schedule for payment of principal and interest. Debt capital is raised by way of issuing debentures or bonds, raising long term loans etc.
- Stock asset- Corporate issue stocks for the purpose of raising their fixed capital. There are mainly two types of stocks such as preference and equity stock. Equity stock holders are the real owners of the organization.Preference shareholders have a preferential right to get a fixed percentage of dividends if there is a profit.

Financial Markets

Financial markets are the centre that facilitate buying and selling of financial instruments, claims or services.It caters the credit needs of the individuals, firms and institutions.It deals with the financial assets of different types such as currency deposits, cheques, bills, bonds etc. it is defined as a transmission mechanism between investors and the borrowers through which transfer of funds is facilitated.It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network for trading the various financial assets and credit instruments.

Nature Of Financial Market

Financial markets are the centre that facilitate buying and selling of financial instruments, claims or services. Financial markets are critical for producing an efficient allocation of capital, allowing funds to move from people who lack productive investments opportunities to people who have them. It caters the credit needs of the individuals, firms and institutions. Financial market deals with the financial assets or instrunents of different types such as currency deposits, cheques, bills, bonds etc. the main participants in the financial markets are financial institutions, agents, brokers, dealers, borrowers, savers,lenders and others who are interconnected by law, contract and communication networks. The important role performed by a financial market is described below.

- They generate and apportion credits.
- They serve as intermediaries in the process of mobilization of savings.
- They provides convenience and benefits to the lender and borrowers.

They promote the economic development through a balanced regional and sectoral allocation of investible funds.

Function Of Financial Markets

Financial markets serve six basic functions. They are briefly listed below.

1. Borrowing and Lending : Financial markets permit the transfer of funds from one agent to another for either investment or consumption purposes.
2. Price Determination: It provides means by which prices are set both for newly issued financial assets and for the existing stock of financial assets.
3. Information Aggregation and Coordination: It acts as collectors and aggregators of information about financial asset values and the flow of funds from lenders to borrowers.
4. Risk Sharing:It allow a transfer of risk from those who undertake investments to those who provide funds for those investments.

5. Liquidity: It provides the holders of financial assets with a chance to resell or liquidate these assets.
6. Efficiency: It reduce transaction costs and information costs.

Types Of Financial Markets

1. Money Market: it is a market for short-term funds normally up to one year. It refers to the institutional arrangement which deals with the short term borrowing and lending of funds. It is a short-term credit market.
2. Capital Markets: it is a market for issue and trading of long-term securities.The term to maturity should be longer than 3 years. The securities traded in capital market are informally classified into short-term, medium-term, and long-term securities depending on their term to maturity.It is market for long term borrowing and lending of funds.
3. Financial Mortgages Market: It is a market through which mortgage loans are granted to individual customers. Mortgage loans are granted against immovable property like real estate. Mortgage is the transfer of an interest in the specific immovable property for the purpose of securing loans.The transferor is called mortgager and transferee is called mortgagee. The common type of mortgage loan, which are seen in india is residential mortgages, housing Development Corporation, National Housing Bank, Housing Finance Companies and Life Insurance Corporation are prominent players in financing residential projects.
4. Financial Guarantees Market:The financial guarantee market is an independent market. It is a financial service market. It is the centre where finance is provided against the guarantee of a reputed person in the financial circle.There are many types of guarantees.The common forms are
    - Performance guarantee: It covers the payment of earnest money, retention money, advance payments etc. these quarantees are given by

the banks to government or public bodies on behalf of ontractors undertaking to pay the penalty in the event of the non-fulfillment o the contract.

- Financial guarantees: It covers only financial contracts. The main sources of guarantee in India are.
    1. Personal guarantee: it is the guarantee given by the individual to obtain loans from cooperative banks or stands as a surety for chit funds etc.
    2. Government guarantee: The centre and state governments are providing guarantees in a number of instances. The government stands as a guarantor for public sector enterprises to obtain finance from the financial institutions.
    3. Institutional guarantee: It is the guarantee provided by the institutions like LIC, statutory financial institutions, specialized financial institutions like credit Guarantee Corporation, Deposit Insurance and Credit Guarantee Corporation etc.

5. Foreign Exchange Market: Foreign exchange refers to the process of conversion of home currencies into foreign currencies and vice versa. According to Kindle Berger: Foreign exchange market is a place where foreign moneys are bought and sold. This market deals with exchange of foreign currency, notes , coins and bank deposits denominated in foreign currency units and liquid claims like drafts, traveler's cheques, letters of credit and bills of exchange expressed in Indian rupee but payable in foreign currency.In india foreign exchange market is the privilege of the Reserve Bank of India.Foreign Exchange Regulation Act (FERA) was passed by the Government of India in 1947, which was later modified in 1973 to regulate foreign exchange market.

CHAPTER-2

Money Market

The money market deals with near substitutions for money or near money like trade bills, promissory notes and government papers drawn for a short period not exceeding one year. It is a mechanism which makes it possible for borrowers and lenders who meet together to deal in short term funds. It does not refer a particular place where short term funds are dealt with. It includes all individuals, institutions and intermediaries dealing with short term funds. It meets the short term requirements of the borrowers and provides liquidity or cash to lenders.

DEFINITIONS

According to Madden and Nadler, “ a money market is a mechanism through which short term funds are loaned and borrowed and through which a large part of the financial transaction of a particular country or of the world are cleared.”

The Reserve Bank of India defines money market as, The centre for dealing, mainly of short term character, in monetary assests, it meets the short term requirements of borrowers and provides liquidity or cash the lenders.”

FEATURES OF A MONEY MARKET

The following are the important features of money market

- It is a market for short-term funds or financial assets called near money.
- It deals with financial assets having a maturity period of one year.
- The borrowers will get fund for period varying from a day, a week. a month, three to six months.
- It is a collection of market for following instruments- call money, notice money, repos, term money, treasury bills, commercial bills, certificate of deposits, commercial papers inter-bank participation certificates, inter-corporate deposits, swaps, bills of exchange, treasury bills, etc.

- Money market consists of several sub markets such as call money market, trade bills market etc, these sub markets have close inter –relationship and free movement of movements of funds from one sub-market to another.
- The borrowers in the money market are traders, manufacturers, speculators and even government institutions.
- It does not refer a particular place where borrowers and lenders meet each other.
- Transactions can be carried through oral or telephonic communications. The relevant documents and written communication can be exchanged subsequently.
- The important components of money markets are the central bank, commercial banks, non-banking financial institutions, discount houses and acceptance houses.
- It does not deal in money but in short term financial instruments or near money assets.
- It is a need based market wherein the demand and supply of money shape the market.

FEATURES OF A DEVELOPED MONEY MARKET

The essential features of a developed money market are given below.

- Well-organized banking system:
- Existence of a central bank:
- Availability of proper credit instrument:
- Proper coordination of different sectors:
- Lack of diversity in money rates of interest:
- Presence of bills market:
- Sufficient resources:
- Existence of secondary market:
- Ample supply of funds:

- Other factors:

FUNCTIONS OF MONEY MARKET

- It facilitates economic development through provision of short term funds to industrial and other sectors.
- It provides a mechanism to achieve equilibrium between demand and supply of short-term funds.
- It facilitates effective implementation of RBIs monetary policy.
- It provides ample avenues for short-term funds with fair returns to investors.
- It instills financial discipline in commercial banks.
- It provides funds to meet short-term needs.
- It enhances capital formation through savings and investment.
- Short-term allocation of funds is made possible through inter-banking transactions and money market instruments.
- It helps employment generation.
- It provides funds to government to meet its deficits.
- It helps to control inflation.
- It provides a stable source of funds to banks in addition to deposits, allowing alternative financing structures and competition.
- It encourages the development of non bank intermediaries thus increasing the competition for funds.
- Savers get a wide range of savings instruments to select from and invest their savings.

COMPONENTS OF INDIAN MONEY MARKET

The money market provides a mechanism for evening out short-term liquidity imbalances within an economy. The development of the money market is thus, a prerequisite for the growth and development of the economy of a country. The main components of Indian money market are:

- Organized money market : these markets have standardized and systematic rules, regulations and procedures to govern the financial dealings .Organized money market are governed and regulated by Government and Reserve Bank of India. It consists of Reserve Bank of India and other banks, financial institutions, specialized financial institutions, non-banking financial institutions, quasi government bodies and government bodies who supply funds through money market.
- Unorganized money market: unorganized market consists of indigenous bankers and money lenders. They collect deposits and lend money. A part from them there are certain private finance companies or non-banking companies, chit funds etc. Reserve Bank of India has taken a number of steps to regulate such type of institutions and bring them in the organized sector. One of such step is issuing of non-banking Financial Companies Act, 1998.
- Sub market: it consists of call money market and bill market. Bill market consists of commercial bill market and Treasury bills market, certificates of deposits, and commercial papers.

STRUCTURE OF INDIAN MONEY MARKET

The main components of Indian money market re unorganized banking sector, organized banking sector with several sub markets which deals with borrowing and lending of short-term credits.

UNORGANIZED BANKING SECTOR

It consists of indigenous bankers and moneylenders in all the country who pursue banking business on traditional lines.

- Indigenous bankers: the Indian Central Banking Enquiry Committee defined Indigenous banks as “ an individual or private firm receiving deposits and dealing in hundies or lending money”. They accept deposits on current accounts and fixed deposits. They lend money to small farmers and traders. Along with this they deal in hundies. They charge exorbitant rate of interest on loans. Certain communities such as Marwaris, Bengalese, Gujarathies, Chettiars and Kallida Kurichi Brahmins do indigenous banking business in India. The main limitation of indigenous bankers is that they follow conservative practices and are not governed by Reserve Bank of India.
- Money lenders: money lenders constitutes one of the components of the organized money market of our country. Money lenders are those persons who do not accept deposits from public, but merely lend their own funds. They lend money mainly for consumption and other domestic purposes. They are mainly two catagories of money lenders .
  1) Professional money lenders: they are those persons whose main business is to lend money. It may be of two types.
     - Resident money lenders : Maharaja, Sahukars, Seths or Banias.
     - Itinerant money lenders: Pathans, Kabulis and Qustwalas.
  2) Non-professional money lenders: these are those persons who combine money lending with other activities.

DEFECTS

1) Their resources are limited to meet the requirement of the rural people.
2) They charge high rate of interest.
3) They grant loans for consumption and unproductive purposes.

4) They provides loans against crops. In this way they compel the consumers to supply the crops to them.

ORGANIZED BANKING SECTOR

It consists of Reserve Bank of India, the State Bank of India and its seven subsidiaries, 19 nationalized banks, the other joint stock banks including commercial banks, co-operative banks, regional Rural Banks, special institutions like LIC, UTI, IDBI, SFCs, NABARD, Exim bank etc. DFHI, non-banking companies and quasi Government bodies and large companies which supply funds in the money market through banks. Reserve Bank of India (RBI) is the central bank and monitory authority of our country. So RBI is the leader of Indian money market.

PARTICIPANTS IN MONEY MARKET

1. Lenders: These are the entities with surplus lendable funds like Banks (commercial, co-operative and Private) Mutual Funds Corporate Entities with bulk lendable resources of minimum of Rs.3 crores per transaction and Financial Institutions.
2. Borrowers: these are entities with deficit funds and include the ones as above.

PLAYERS OR ORGANIZATIONS IN MONEY MARKET

Money market is dominated by a small number of large players. The Reserve bank of India is the most important constituent of Indian Money market. Some important players in the money market are:

1. Government.
2. Reserve Bank of India.
3. Discount and finance House of India.
4. Banks.
5. Financial Institution.
6. Corporate firms.
7. Mutual funds.

8. Non- banking financial companies.
9. Primary Dealers.
10. Securities Trading Corporation of India.
11. Provident Funds.
12. Public sector undertakings.(PSU).

RESERVE BANK OF INDIA

It is the nerve centre of the financial and monetary system.RBI possesses special status in our country. It is the authority to regulate and control the monetary system of our country. The preamble to the Reserve Bank of India Act states that the object of establishing Reserve Bank of India is , "to regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

The main function of RBI is to maintain monetary stability and to maintain stable payment system. The other important function of RBI is to regulate overall volume of money and credits in the economy with a view to ensure a reasonable degree of price stability.RBI influences liquidity and interest rates through a number of operating instruments such as cash reserve requirement of banks, conduct of open market operations, repos, change in bank rates, and at times of foreign exchange swap operations. The roles RBI plays in Indian financial system as a regulator relate to,

- Note issue authority.
- Government banker.
- Bankers bank.
- Supervising authority.
- Exchange control Authority.
- Promoter of the financial system and,
- Regulator of money and credit.

1. NOTE ISSUING AUTHORITY

According to section 22 of the Reserve Banks of India Act, the Reserve Bank has given the sole right to issue currency notes other than one rupee coins and notes and subsidiary coins in our country. Currency notes of rupee one and other subsidiary coins are issued by the Ministry of Finance of the Government of India through Reserve Bank.

2. GOVERNMENT BANKER

The reserve bank acts as a Banker, agent and advisor to the Government as per the obligations created under the section 20, 21, and 21(a) of the Reserve Bank of India Act.

As A Banker: the Reserve Bank have statutory obligation of keeping money of the Central and State Government and provide other services free of charge. It makes payments on behalf of the central Government through its branches and the branches of the State Bank of India all over the country.

As A Financial Advisor: the bank acts a financial advisor to the central and state Governments. It assists them generally to formulate financial and economic policies.

As A Financial Agent: the bank is the representative of Government of India in the World Bank and International Monetary fund. It sells treasury bills on behalf of the Central Government. It acts as the agent of the central and state governments in the matter of floatation of loans.

3. BANKERS BANK AND LENDER OF THE LAST RESORT:

RBI has the right to control and supervise the activities of all banks in the country by way of issuing license, giving permission etc. it controls the volume of their reserve and determines their deposit credit creation ability.

4. .SUPERVISING AND REGULATING AUTHORITY:

RBI is the regulator and supervisor of monetary system. It provides broad parameters with in which the banking and financial system of our country functions.

It regulates the money market according to the provisions of the RBI act and the banking regulation act.

5. *EXCHANGE CONTROL AUTHORITY*

RBI develops and regulates the foreign exchange market. Its role is to facilitate external trade and payment and provide or orderly development and maintenance of foreign exchange market within the frame work of FEMA.

6. *PROMOTER OF THE FINANCIAL SYSTEM*

RBI has taken a number of steps to promote financial system. It created certain financial institutions and helped other financial institutions to develop. Example: IDBI ,IFCI,SFCs, IIBI, EXIM BANK, UTI, SIDBI, NABARD etc.

7.*REGULATOR OF MONEY AND CREDIT*

RBI formulates and conducts the monetary policy. Monetary policy refers to the use of the techniques of monetary control to achieve the broad objectives of maintaining price stability and to ensure adequate flow of credit to productive sectors for helping economic growth. The following are the important monetary techniques used for monetary control.

- ***OPEN MARKET OPERATIONS.***
- ***BANK RATE.***
- ***REFINANCE.***
- ***CASH RESERVE RATIO.***
- ***STATUTORY LIQUIDITY RATIO.***
- ***LIQUIDITY ADJUSTMENT FACILITY.***
- ***REPOS/ RESERVE REPOS.***

FINANCIAL INSTITUTIONS

They undertake lending and borrowing of short-term funds, they also lend money to banks by rediscounting Bills of Exchange.

CORPORATE FIRMS

Corporate firms operate in money market to raise short-term funds to meet their working capital requirements. They issue commercial papers with a maturity period of 7 days to 1year.

INSTITUTIONAL PLAYERS

They consist of Mutual funds, foreign Institutional players, insurance Firms, etc. their participation depends on the regulations. For instance the level of participation of the FIIs in the Indian money market is restricted to investment in Government Securities.

DISCOUNT HOUSES AND PRIMARY DEALERS

Discount houses discount and rediscount commercial bill and treasury bills. Primary dealers were introduced by RBI for developing an active secondary market for Government securities.

IMPORTANCE OF MONEY MARKET

The money market is an integral part of a country's economy. The money market is an indispensable necessity for the economic development of a country. A developed money market helps the development of country in a number of ways.

1. ***DEVELOPMENT OF CAPITAL MARKET***: capital market deals with medium and long term lending and borrowing of funds. The short-term interest rates and the conditions prevailed in the money market influences the interest on long term lending and resource mobilization in the market.
2. ***FINANCING TRADE***: Money market plays crucial role in financing both internal as well as international trade. The acceptance houses and discount market help in financing foreign trade.
3. ***FINANCING INDUSTRY***: money market contributes to the growth in two ways:

- Money market helps the industries in securing short-term loans to meet their working capital requirements through the system of financial bills, commercial papers etc.
- Money markets help to grow industries by providing short-term loans to meet working capital requirements through discounting operations and commercial papers.

7. ***HELPS COMMERCIAL BANKS***: money market enables the commercial banks to use their excess reserves in profitable investment. The main objective of the commercial banks is to earn income from its reserves as well as maintain liquidity to meet the uncertain cash demand of the depositors.
8. ***HELPS CENTRAL BANK***: it acts as a guide to central bank for adopting an appropriate banking policy. Money market helps the central bank in two ways:
   - The short run interest rates of the money market serves as an indicator of the monetary and banking conditions in the country.
   - The sensitive and integrated money market helps the Central bank to secure quick and widespread influence on the sub-markets and thus achieve effective implementation of its policy.
9. ***GUIDE AND HELP TO GOVERNMENT***:
10. ***ENCOURAGES SAVINGS AND INVESTMENT:***

MONEY MARKET ORGANIZATION

Money market is a Heterogeneous Market which consist of sub markets. It consists of:

1. CALL MONEY MARKET: it is sometimes referred as “ loans or money at call and short notice’’. The rate at which funds are borrowed and lend in this market is called the call money rate.

FEATURES OF CALL MONEY MARKET

- The call market enables the banks and institutions to even out their day to day deficits and surpluses of money.

- Commercial banks, co-operative Banks and primary dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements.
- Specified All Indian Financial Institutions, Mutual Funds and certain specified entities are allowed to access call/ Notice money only as lenders.
- It is a complete inter-bank market hence non-bank entities are not allowed access to this market.
- Interest rates in the call and notice money markets are market determined.
- The borrowers and the lenders are required to have current accounts with Reserve Bank of India.
- It serves as an outlet for deploying funds on short-term basis to the lenders having steady inflow of funds.

OPERATIONS:

The borrowers and lenders contact each other through telephone in the call market. After negotiation the lender issues cheques in favour of the borrower. After receiving the cheques, the borrower issues a receipt. On payment of loan and interest the receipt is returned to the lender.

CALL MONEY MARKETS IN INDIA

The call money market are mainly located in developed, industrial centres like Mumbai, Kolkata, Ahmadabad, Delhi, Chennai etc. the banks that are in need of temporary funds will take this loan from the banks that have excess funds. So this is called interbank call money market. Call loans are provided for the following purposes.

- It is given to commercial banks to meet huge payments, bulky remittances and to maintain statutory requirements with RBI.

- It is provided to the stockbrokers and speculators to deal in stock exchanges and bullion markets.
- It is allowed to high status individuals for trade purposes to save interest on overdraft or cash credit.
- It is provided to the Discount and Finance Houses of India (DFHI) and Securities Trading Corporation of India to activate the call money.
- It is given to bill markets to meet matured bills.

i. LOAN MARKET

The period of this type of loans is over 14 days and generally up to 90 days without any collateral securities. The lenders cannot recall these loans back before maturity. DFHI is the important institution which plays an important role in the call and inters bank loan market by arranging, lending and borrowing short- term funds.

MERITS OF CALL MONEY MARKET

- Profitability.
- High Liquidity.
- Helps To Maintain Statutory Reserve Requirements.
- Safe.
- Helps The Central Bank.

DEMERITS OF CALL MONEY MARKET

- Confined to big cities.
- Lack of integration.
- Call money rates volatile in nature.
- Small size.
- Commercial banks are not inclined to offer loans to brokers and dealers in bills and securities.

COMMERCIAL BILL MARKET OR DISCOUNT MARKET

Commercial bill or the bills of exchange popularly known as bill is a written instrument containing an unconditional order.The bill is signed by the drawer directing a certain person to pay a certain sum of money only to or order of a certain person or to bearer of the instrument at a fixed time in future or on demand.

A well organized bill market or discount market for short term bill is essential for establishing an effective link between credit agencies and Reserve Bank of India.

- Preference for cash to bills.
- Lack of uniform practices with regards to bills.
- Excessive stamp duty.
- Preference for cash credit and overdraft arrangements as a means of borrowing from commercial banks.
- Lack of specialized discount houses.

  Reserve bank of India started making efforts in this direction in 1952. However a new bill market was introduced in 1970. There has been substantial improvement since then.

TREASURY BILLS

Treasury bill is a short term government securities usually of the duration of 91 days sold by the central bank on behalf of the government. There is no fixed rate of interest payable on the treasury bills. These are sold by the central bank on the basis of competitive bidding. Treasury bills are highly secured and liquid because of guarantee of repayment assured by the RBI who is always willing to purchase or discount them.

TYPES OF TREASURY BILLS.

Treasury bills are basically classified into two types.

- **ORDINARY/ REGULAR TREASURY BILLS**: these are issued to the public and the RBI by a process of auction or bidding. The objective is to meet the additional short term financial needs of the government. Bids are invited usually for 14 days, 182 days, 91 days and 364 days treasury bills.

- **ADHOC TREASURY BILLS**: these are issued in favour of RBI with a view to replenish Government's cash balances by employing temporary surpluses of state government and semi government departments.

  Banks are the main subscribers to such treasury bills because they offer a stable and attractive returns, high liquidity and can be encashed at a very short notice with RBI.

CALL AND SHORT NOTICE MONEY

Call money refers to a money given for a very short period. It may be taken for a day or overnight but not exceeding seven days in any circumstances. Surplus funds of the commercial banks and other institutions are usually given as call money.

CERTIFICATE OF DEPOSITS

As per the Reserve Bank of India Certificate of Deposit is a negotiable money market instrument and issued in dematerialized form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institutions for a specified time period.

Certificate of Deposits are marketable receipts in bearer or registered form of funds deposited in a bank or other eligible financial institution for a soecified 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. Reserve Bank of India launched a scheme in June 1989 permitting banks to issue CDs. The Reserve Bank of India has modified its guidelines from time to time. At present the minimum amount of a CD should be Rs.1 lakh and in multiples of Rs. 1 lakh thereafter. The maturity period of certificate of deposit at present should not be less than 7 days and not more than one year from the date of issue in case of CD issued by a bank. The financial institutions can issue CDs for a period not less than one year and not exceeding three years from the date of issue.

COMMERCIAL PAPERS

CPs are short term promissory notes issued by reputed companies with good credit standing and having sufficient tangible assests. CPs are unsecured and are negotiable by endorsement and delivery. CPs are normally issued by banks, public utilities, insurance and non banking financial institutions. CPs in India were launched by the RBI's notification in January 1990. With a view to enable highly reputed companies to diversify their sources of short term borrowings and also to provide an additional instrument to investors. The issuing company is required to meet the stamp duty, credit rating agency fees, stand by facility charges etc. the maturity period of CPs was 30 days.

REPURCHASE AGREEMENT [REPO]

It is very important instrument of the money market. It enables smooth adjustment of short term liquidity among varied categories of market participants. As it is a market based instrument it serves the purpose of an indirect instrument of monetary control in a liberalized financial market. The monetary policy of 1999-2000 recognised that the Repo rates are being increasingly accepted by the market as signals for movement in the market rate of interests especially the call money rates.

CONCEPT

Repo(Repurchase Agreement) is a money market instrument which enables collateralized short term borrowing and lending through sale/ purchase operations in debt instruments. Repo rates is the annualized rate for the funds transferred by the lender to the borrower. Repo is also called ready forward transaction as it involves selling a security on spot basis and repurchasing the same on forward basis. An active Repo market leads to increase in the money market turnover and the central bank of the country can use it as an integral part of open market operations.

ADVANTAGES OF REPOs

The following are some of the important advantages that Repos can provide to the financial and debt markets of a country.

- An active repo market leads to increase in the turnover of the money market.
- It improves liquidity and depth of the money market.
- It enables smooth adjustment of short term liquidity among varied categories of market participants.
- Repo is a tool for funding transactions. It provides a cheaper and most efficient way of improving liquidity in the secondary markets.
- Repos are a source of inexpensive finance for institutions.
- Reserve Bank of India can use repos as a tool of open market operations for injecting or withdrawing liquidity from the market.
- It can be used as indirect instruments of monetary control in the financial market.

INTER BANK PARTICIPATION CERTIFICATES (IBPCs)

The inter bank participation certificates are the inter bank money market instruments used by commercial banks to park their surplus funds. These IBPCs are of two types.

- With risk sharing IBPCs: These certificates are issued for 91 to 180 days and interest is determined on these PCs between the issuing and participating bank freely.
- Without risk sharing IBPCs: These IBPCs are money market instruments not exceeding 90 days. The interest on these PCs is determined by the two contracting banks.

PLAYERS IN THE INDIAN MONEY MARKET

The following are the major players in the Indian money market.

- Reserve Bank of India.

- Financial institutions like IFCI, IDBI, ICICI, IRBI, LIC, UTI etc.
- Commercial banks including scheduled as well as non- scheduled commercial banks, private banks, foreign banks, state bank of india and its subsidiaries, cooperative banks etc.
- Discount and Finance House of India.
- Brokers.
- Provident Funds.
- Public sector undertakings.
- Corporate units,etc.

DEFECTS OF THE INDIAN MONEY MARKET

- Existence of unorganized Money Market.
- Lack of integration.
- Disparity in interest rates.
- Seasonal diversity of money market.
- Lack of proper bill market.
- Lack of very well organized banking System.

THE REFORMS IN THE INDIAN MONEY MARKET

The Reserve Bank of India has been making efforts to remove the defects of th Indian money market. Vaghul Committee on money market Sukhmoy Chakravarty Committee on the Review of the working of the Monetary System and Narasimham Committee on the working of Financial System have made important recommendations on the Indian money market.

1. Development of money market instruments: The new instruments are 182 days treasury bills, longer maturity bills, dated Government securities, certificates of deposits and commercial papers, 3-4 days repos and 1 day repos from 1998-1999. The 182 days bills which were discontinued in 1992 have been reintroduced from

1998-1999. Now Indian money market has 14 days, 91 days, 182 days and 364 days treasury bills.

2. Deregulation of interest rates: Helps banks to accustom better pricing of assets and liabilities and to the need to manage interest rates across their balance sheet.
3. Institutional Development: The institutional infrastructure in government securities has been strengthened with the system of primary Dealers announced in March 1995 and that of satellite Dealers in December 1996.
4. Money market mutual funds: In 1992 setting up of money market mutual funds was announced to bring it within the reach of individuals. These funds have been introduced by financial institutions and banks.
5. Permission to foreign institutional investors (FIIs): FIIs are allowed to operate in all dated government securities. The policy for 1998-1999 has allowed them to buy treasury Bill’s within approved debt ceiling.

CHAPTER-3

Capital Markets

The term capital market refers to the institutional arrangements for faciitating the borrowing and lending oflong-term funds. It is concerned with those private savings, individuals as well as corporate, that are turned into investments through new capital issues and also new public loans floated by government and semi-government bodies.

A capital market may be defined as an organised mechanism for effecive and efficient transfer of money capital or financial resources from investing parties, i.e, individuals or institutional savers to the enterpreneurs engaged in industry or commerce in the business either be in the private or public sectors of an economy.

Objectives and Importance

An efficient capital market is a pre-requisite of economic development. An organised and well developed capital market operating in a free market economy.

1. Ensures best possible coordination and balance between the flow of savings on the one hand and flow of investment leading to capital formation on the other.
2. Directs the flow of savings into most profitable channels and thereby ensures optimu utilisation of financial resources.

Characteristics of Capital Market

The following are the important features of a developed capital market

- Market for long term funds.
- Important component of financial system.
- Facilitates borrowing and lending of funds.
- Helps in raising capital.
- Involves both individual and institutional investors.
- Meets demand and supply of long term capital.

- Involves intermediaries.
- Deals in marketable and non-marketable securities.

Functions of Capital Market

1. Helps in capital formation.
2. Act as a link between savers and investors.
3. Helps in increasing national income.
4. Facilitates buying and selling.
5. Channelizes funds from unproductive to productive resources.
6. Minimises speculative activities.
7. Brings stability in value of stocks.
8. Promotes econmic growth.
9. Play important role in underdeveloped country.

Structure of the Indian Capital Market

The capital market in India may be classified into categories, organised and onorganised. In organised sector of capital market demand forlong term capital comes from corporate enterprises, public sector enterprises, government and semi-government institutions.

In India even the organised sector of capital market was ill developed till recently because of the following reasons;

- Agriculture was the main occupation which did not lend itself to the floatation of securities.
- The foreign business houses hampered the growth of securities market.
- Managing agency system also accounted for ill-development of capital market as managing agents performed both activities of promotion and marketing of securities.
- The investment habit of individuals

- Restrictions imposed onthe investment pattern of various financial institutions.

The unorganised sector of the capital market consists of Indigeneous Bankers and Private Money-lenders.

Broad Constituents in the Indian Capital Markets

A capital market constitutes the following;

1. **Fund Raisers**: Companies that raise funds from domestic and foreign sources, both public and private.
2. **Fund Providers:** The entities that invest in the capital markets.these includes subscribers to primary market issues, investors who buy in the secondary market, traders, speculators, foreign institutional investors, mutual funds, venture capital funds, NRIs, ADR/GDR investors, etc.
3. **Intermediaries:** Are service providers in the market, including stock brokers, sub-brokers, financiers, merchant bankers, underwriters, depository participants, registrar and transfer agents, portfolio managers, custodians, etc.
4. **Organizations:** Include various entities such as MCX-SX, BSE, NSE, other regional stock exchanges and the two depositories National Scurities Depository Limited(NSDL) and Central Securities Depository Limited (CSDL).
5. **Market Regulators**: Includes the securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI) and the Department of Company affaires (DCA).

Components of Capital Market

The Indian Capital Market is broadly divided into Gilt-Edged Market and the Industrial Securities Market.

1. **Gilt-Edged Market**: Refers to the market for government and semi-government securities backed by Reserve Bank of India (RBI). Government securities are tradable debt instruments issued by the Government for meeting its financial

requriments. It is also called gilt edged securities market. The term gilt-edged means “ of the best quality”.

2. **Industrial Securities Market**: Refers to the market whic h deals in equities and debentures of the corporate. It comprises of the most popular instruments ie, equitity shares, preference shares, bonds and debentures. It is further divided into three types.
    - New issue market or primary market.
    - Stock market or secondary market.
    - Financial institutions.

CHAPTER-4

Development Financial Institutions

Role of financial institutions

Financial institutions provide means and mechanism of transferring resources from those who have an excess of income over expenditure to those who can make productive use of the same. These institutions help economic development in the following ways.

1. **Providing funds:** these institutions help large number of persons for taking up some industrial activity. The addition of new industrial units and increasing the activities of existing units will certainly help in accelerating the pace of economic development. Financial institutions have large investible funds which are used for productive purposes.
2. **Infrastructural facilities**: financial institutions prepare their investment policies by keeping national priorities in mind. The institutions invest in those areas which can help in increasing the development of the country.
3. **Promotional activities:** financial institutions have the expertise and manpower resources for undertaking the exercise of starting a new unit. So these institutions take up this work on behalf of entrepreneurs. The promotional role of financial institutions is helpful in increasing the development of a country.
4. **Development of backward areas**: in order to help the development of backward areas financial institutions provide special assistance to entrepreneurs for setting up new units in these areas. IDBI, IFCI, ICICI give priority in giving assistance to units set up in backward areas and even charge lower interest rates on lending. Such efforts certainly encourage entrepreneurs to set up new units in backward areas.

5. **Planned development**: different institutions earmark their spheres of activities so that every business activity is helped. Some institutions like SIDBI, SFCI's especially help small scale sector while IFCI and SIDC's finance large scale sector or extend loans above a certain limit. Some institutions help different segments like foreign trade, tourism etc.
6. **Accelerating industrialization:** the setting up of more industrial units will generate direct and indirect employment make available goods and services in the country and help in increasing the standard of living. Financial institutions provide requisite financial, managerial, technical help for setting up new units.
7. **Employment generation**: they have employed many persons to man their offices. Besides office staff institutions need the service of experts which help them in financing lending proposals. They also help in creating employment opportunities in backward areas by encouraging the setting up of units in those areas.

INDUSTRIAL FINANCE CORPORATION OF INDIA

The objective of the corporation as laid down in the preamble of the IFC Act 1948 are " making medium and long term credits more readily available to industrial concerns in India particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital issue methods is impracticable." The authorized capital of the corporation was Rs.10 crore which was divided in equities of Rs. 5000 each. Later on the authorized capital was increased to Rs. 20 crore. Since july 1, 1993 this corporation has been converted into a company and it has been given the status of a limited company with the name Industrial Finance Corporation of India Ltd.

Functions of IFCI

The functions of the IFCI can be broadly classified into:

1. Financial assistance:The IFCI is authorized to render financial assistance in one or more of the following forms.

- Granting loans or advances to or subscribing to debentures of industrial concerns repayment within 25 years.
- Underwriting the issue of industrial securities to be disposed off within 7 years.
- Subscribing directly to the shares and debentures of public limited companies.
- Guaranteeing of loans raised by industrial concerns from scheduled banks or state cooperative banks.
- Guaranteeing of deferred payments for the purchase of capital goods from abroad or within India.
- Acting as an agent of the Central Government or the World Bank in respect of loans sanctioned to the industrial concerns.

Financial assistance is available from IFCI for the following purposes:

- For setting up of new industrial undertaking.
- For expansion or diversification of the existing concerns.
- For the modernization and renovation of the existing concerns.
- For meeting existing liabilities or working capital requirement of industrial concerns in exceptional cases.

2. Promotional activities: It helps in developing small and medium scale entrepreneurs by providing them guidance through its specialized agencies in identification of projects, preparing project profiles, implementation of the projects. Etc. it acts as an instrument of accelerating the industrial growth and reducing regional industrial and income disparities.
3. Financial services: Financial services provided by IFCI includes:
    - Corporate counseling for financial reconstruction.

- Assistance in settlement of terms and conditions with foreign collaborators.
- Revival of sick units.
- Financing of risky projects etc.

INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)

The Industrial Development Bank of India was established under the Industrial Development Bank of India Act 1964. The ownership of IDBI has since been transferred to Central Government from Feb 16, 1976. The main object of establishing IDBI was to set up an apex institution to co-ordinate the activities of other financial institutions and to act as a reservoir on which the other financial institutions can drawn. IDBI provides direct financial assistant to industrial units also to bridge the gap between supply and demand of medium and long term finance.

FUNCTIONS

The main functions of IDBI are as follows:

1. To co-ordinate the activities of other institutions providing term finance to industry and to act as an apex institution.
2. To provide refinance to financial institutions granting medium and long term loans to industry.
3. To provide refinance to scheduled banks or co-operative banks.
4. To provide refinance for export credits granted by banks and financial institutions.
5. To provide technical and administrative assistance for promotion, management or growth of industry.
6. To undertake market surveys and techno economic studies for the development of industry.
7. To grant direct loans and advances to industrial concerns.
8. To render financial assistant to industrial concerns.

NABARD (NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT)

NABARD was established on July 12, 1982 as an apex banking institution by an act of parliament. NABARD Bill 2000 was accepted by the president in January 2001. Under this Act the authorized capital has been raised from Rs. 500 crore to Rs. 2000 crore. NABARD obtains funds from Government of India, World bank and other agencies.

MANAGEMENT

Deputy Governor of RBI has been appointed as the chairman of NABARD. The board of National Bank includes three Central Board of Directors being nominated by the Government.

FUNCTIONS

Its main function include:

i. To refinance the loans granted by the State Government, State Co-operative Bank, Land Development Bank and other financial institutions for purposes of rural development.
ii. To perform all the functions relating to agricultural credit.
iii. To execute/ implement rural development programmes funded by the World Bank and other International Development Agencies.
iv. To co-ordinate the activities of Central and State Governments, the planning commission and other institutions involved with the development of SSIs, village and cottage industries etc.
v. To extend long term loans to state Government to enable them to subscribe to the share capital of co-operative credit societies.
vi. To promote research in agriculture and rural development, to formulate and design projects and programmes to suit the requirements of different areas.

NABARD operates throughout the country through its 28 Regional offices and one sub-office located in the capital of all the states/ union territories

FARM SECTOR SCHEMES

NABARD provides policy support for various farm sector initiatives. It has helped in increasing agricultural production and productivity generating rural employment, managing natural resources and eliminating rural poverty by extending credit and grant support.

KISAN CREDIT CARD SCHEME

NABARD formulated a Model Kisan Credit Card Scheme in consultation with major banks. The Model Scheme was circulated by RBI to commercial banks and by NABARD to co-operative banks and RRBs in August 1998.

RURAL NON-FARM SECTOR (RNFS)

NABARD has also formulated various non-farm sector schemes for promotion, development and financing so as to generate employment and increase income in rural areas. The following are some of the important refinance schemes of NABARD for non-farm sector:

1. Composite loan scheme.
2. Integrated loan scheme.
3. Soft loan assistance scheme for providing margin money.
4. Small road and water transport operators scheme.
5. Pre-sanction procedure schemes such as term loan to small scale industries, cooperatives and agro industries.

DISTRICT RURAL INDUSTRIES PROJECT (DRIP)

The objective of the project is to create significant number of employment opportunities in rural areas through industrialization. NABARD Plays an important role in the implementation of DRIP by:

i. Providing 100 percent refinance to banks for lending to rural non farm sector.
ii. Conducting potential surveys of the districts.
iii. Associating in organization of special programmes and promotional activities.
iv. Providing financial assistance in the form of grants to select agencies.
v. Reviewing and guiding the progress of projects under DRIP.

STATE FINANCIAL CORPORTIONS (SFCs)

The main objectives of SFCs is to provide financial assistance to all types of industrial units in small and medium scale. They help both new as well as existing units for purposes of establishment, modernization, renovation, expansion and diversification. They can assist industrial concerns engaged in any of the following activities:

a) Manufacturing, preservation or processing of goods.
b) Mining.
c) Hotel industry.
d) Road transport.
e) Generation or distribution of electricity or any other form of power.
f) Development of any area of land as an industrial estate.
g) Fishing or providing facilities for fishing or manufacture thereof.
h) Providing special or technical knowledge or other services for the promotion of industrial growth.

FUNCTIONS OF SFC's

State financial corporations are authorized to grant financial assistance in the following forms:

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

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

iii. Guaranteeing loans raised by industrial concerns repayable within a period of twenty years.

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

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

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

PERFORMANCE APPRAISAL

SFC’s have been helping in accelerating the rate of Industrial growth. Their performance can be summarized as follows.

i. SFC’s are substantially contributing to the development of small scale industries.

ii. The loan recovery has remained a problem within the corporations.

iii. SFC’s should review their role under new economic environment and should diversify into financial services.

iv. SFC’s should be given more autonomy in their working by amending State Corporations Act.

PROBLEMS

SFC’s have suffered from some weaknesses which have hindered their progress. Some of these problems are as below:

i. Default in collecting loans.

ii. Inadequate records.

iii. Insufficient securities.

iv. Lack of technical personnel.

v. Inadequate resources.

SMALL INDUSTRIAL DEVELOPMENT BANK OF INDIA (SIDBI)

SIDBI was set up in 1990 under the SIDBI Act 1990. The main objective of SIDBI has been to work as a principle financial institution for the promotion, financing and development of industries in the small scale sector.

FUNCTIONS OF SIDBI

Initially SIDBI performed the following functions:

i. Refinancing of the term loans granted by SFC’s, SIDCs, bank and other financial institutions.

ii. Rediscounting of short term trade bills arising out of sale of product of the small scale sector.

iii. Direct discounting/ rediscounting of bills arising out of scale of machinery/ capital equipment on deferred credit manufacture by small scale sector.

Presently SIDBI is performing following functions:

i. It renders equity type of assistance to new promoters, women and ex-servicemen under National Equity Fund.

ii. It provides assistance to the voluntary organizations working for development/ upliftment of under priviledged women.

iii. It also provides technical support to small scale sector for promotion, development and growth.

iv. It also extends financial support to NSIC and SIDCs for purchase of material and marketing of SSI product and for financing hire-purchase and leasing activities.

UNIT TRUST OF INDIA (UTI)

The unit trusts provide an opportunity to small and medium investors to make investments indirectly in those stocks in which they could not have made otherwise. Unit trusts help investors to obtain high return, low- risk combination for their indirect holding of equities and other assets. The Unit Trust of India was established by Government of India under the Unit Trust of India Act, 1963. The trust was accordingly set up in February 1964. At present UTI is governed by SEBI MF Regulations and it works on a three-tier structure of sponsors, trustees and AMC.

OBJECTIVES OF UTI

i. To stimulate and pool the savings of the middle and low income groups.
ii. To enable unit holders to share the benefits and prosperity of the rapidly growing industrialization in the country.
iii. To sell units among as many investors as possible.
iv. To invest the money raised from the sale of units and its own capital in corporate and industrial securities.
v. To pay dividend to the unit holders.

SCHEMES OF UTI

1. Some of the important schemes of UTI include the following:
   a) OPEN ENDED UNIT SCHEMES.
      2. Unit scheme-1964.
      3. Unit scheme-1971
4. Unit scheme for Charitable and Religious Trusts and Registered Societies, 1981.
5. Capital gain unit scheme, 1983.
6. Children's Gift Growth Fund (CGGF) unit scheme, 1986.
7. Housing unit scheme. 1992.
8. Bhopal Gas Victims monthly income plan, 1993.

9. Senior citizen unit plan. 1993.
10. Institutional investors special unit fund scheme, 1993.

(b) CLOSE ENDED SCHEMES.

1. Monthly income unit schemes issued in 1987,1988,1989.
2. Growing income unit scheme issued in 1987.1989,1990.
3. Deffered income unit scheme issued in 1990.1991,1992.
4. Mutual fund unit scheme 1986.
5. Master share plus scheme 1991.
6. Master equity plans issued in 1991,1992,1993.

In June 1998, UTI launched two new schemes, the amount to be mobilized under these two schemes was to be invested in shares. The schemes were:

1) INDEX FUND (open ended scheme) Mobilised fund under this scheme were invested in 30 companies associated with SUNSEX of Bombay Stock Exchange (BSE).
2) MASTER VALUE (closed ended scheme) the mobilized funds under this scheme were invested in “B” Group companies of BSE.

UTI sells its units at the lowest price in July every year because UTI declares dividend on units upto June end. UTI has brought its three schemes namely ULIP, CCF, CRTS under SEBI since July 2000. Now leaving only US-64 all the scheme of UTI are under SEBI regulations.

CHAPTER-5

Mutual Funds

The concept of mutual fund is a new feather in the cap of indian capital market but not to international capital markets. In india first mutual fund started in 1964 when United Trust of India(UTI) was established in the similar ine of operation of the UK based Investment Trust Companies.

TYPES OF MUTUAL COMPANIES

There are a number of mutual funds to suit the needs and oreferences of investors. To achieve the differing objectives of the investors, mutual funds adopt different strategies and accordingly offer different schemes. The various mutual funds may be classified under five broad categories:

1. ***According to ownership:***

   According to ownership, mutual funds in India may be classified as

   - Public sector mutual funds: United Trust of India(UTI) has been functioning in the arena of Mutual Fund business in India since 1963-1964. It was only after 23 years in 1987 that a second fund was established in India by the State Bank Of India. SBI mutual fund was the first among all the public sector commercial banks that started operations during November 1987. Thereafter a number of public sector organisation like IND Bank MF, CAN Bank MF, BOI MF, PNb MF LIC MF etc joined in the mutual fund business in a short span of time.
   - Private sector Mutual Funds: the Government of India allowed the private sector corporates to join the Mutual Fund Industry on February 14, 1992. SEBI regulations, 1996 provide guidelines for registration, constitution, management and schemes of mutual funds.

2. ***According to the scheme of operation:***

According to the scheme of operaions the Mutual funds could be divided into three categories.

- Open- ended schemes/funds: open ended scheme means a scheme of Mutual funds which offers units for sale without specifying any duration for redemption.these schemes do not have a fixed maturity and entry to the fund is always open to investors who can subscribe it at any time. The investor have a option to get their holdings redeemed at any time.the fund redeems or repurchases the units/ shares at periodically announced rates. These repurchase rates are based upon the net current assest value of the fund. The Unit scheme 1964 of UTI, ULIP,dhanraksha and Dhanvirdhi of LIC Mutual fund are some of the examples of open ended schemes.
- Closed-ended schemes /funds: A closed ended scheme means any scheme of mutual fund in which the period of maturity of the scheme is specified. The corpus of close-ended scheme is fixed and an investor can subscribe directly to the scheme only at the time of initial issue. After the initial issue is closed a person can buy or sell the units of the scheme in the secondary market. It is always easier to manage a close-ended scheme as the fund managers can evolve long term investment strategies depending upon the life of the scheme. Dhanshree and Dhanasamardhi of LIC mutual fund, Canshare of Canara Bank, Ind Jyothi and Swaran Jyothi of Indian Bank are some of the examples of closed ended mutual fund schemes
- Interval schemes/ funds: An interval scheme is a scheme of Mutual und which is kept open for a specific interval and after that it operates as a closed scheme.Interval schemes have been permitted by the SEBI in recent years only. The scheme is open for scale or reurchase at fixed predetermined intervals which are disclosed in the offer document.

3. ***According to portfolio***: mutual funds can also be classified according to portfolio or the objectives of the fund. Some of these funds are disscussed as follows.

    - Income funds: These funds aim at providing maximum current return to the investor. There may be income funds of two types. Some funds may concentrate on low risk, constant returns while others, may aim at maxmum return even at the cost of some risk.
    - Growth funds: These funds aim at providing capital appreciation in the value of investment. Such funds invest in growth oriented securities have a potential to appreciate in long run.
    - Balanced or conservative funds: Balanced funds spend both on common stock and preferred stock. Some part of funds is spent on buying equity while other part is used in acquiring interest bearing debentures and preference shares ensuring certain amount of dividend.
    - Stock/ equity fund: These are mainly invested in shares of the companies. The investments may vary from blue chi copanies to newly established companies.
    - Bond funds: These funds employ their resources in bonds.tese investments ensure fixed and regular income.
    - Specialised funds: These invest in a particular type of securities of companies dealing in a particular product, firms in a particular industry or of certain income producing securities.
    - Leverage funds:These maximise capital appreciation.these may even use borrowed funds for buying speculative stock which ensures a profit in the future

- Taxation funds: Mutual funds may be designed to suit the tax payers. The contributors to such funds get some concession in income tax.
- Money market mutual funds: These instruments include treasury bills, dated government securities with an unexpired maturity of upon one year, call and notice money, commercial paper, commercial bils accepted by banks and cerificates of deposits.

4. ***According to location:***
    - Domestic funds. These are the funds which mobilise sevings of people within the country where investment are made.
    - Off-shore funds: Off-shore mutual funds are those which raise or mobilise funds in country other than where investments are to be made. These funds attract foreign savings for investment in India.
5. ***According to market capitalisation***.
6. ***Other types of mutual funds***: Such as Loan funds, and Non-loan funds based upon the expenses/ fees to be charged. Hub and spoke funds which are basically fund of funds, etc.

ADVANTAGES OF MUTUAL FUNDS

i. Diversificaion
ii. Expert supervision and managament.
iii. Liquidity.
iv. Reduced risk
v. Tax advantage.
vi. Low operating costs.
vii. Flexibility.
viii. Higher returns.
ix. Investor protection.

PROBLEMS OF MUTUAL FUNDS IN INDIA

The following are some of the main problems that are being faced by Indian mutual funds.

1. Liquidity crisis.
2. Lac of innovation.
3. Inadequate research.
4. Conventional pattern of investment.
5. No provision for performance guarantee.
6. Inadequate disclosures.
7. Delays in service.
8. No rural sector investment base.
9. Poor risk management.

SEBI GUIDELINES ON MUTUAL FUNDS

Mutual funds in India are now governed under the Securities and Exchange Board of India(mutual fund) Regulations,1996. SEBI has provided a four tier system for managing the affairs of mutual funds. The four constituents in the organisation of a mutual funds are:

1. **The sponsoring company, called Sponsor:** SEBI(mutual funds) Regulations define Sponsor as any person who acting alone or in combination with another body corporate, establishes a mutual fund. SBI Mutual fund is sponsored by State Bank of india, LICMF is sponsored by Life Insurance Corporation (LIC) of India. Sponsors have to comply with the following regulations laid down by SEBI.
    a. Application and fee: a sponsor has to file an application for registration of a mutual fund in the prescribed form along with an application with fee of Rs.100000. the sponsors must furnish all information and give clarifications as may be required by the board.

b. Eligibility criteria: the sponsor may be granted a certificate of registration provided following conditions are satisfied.
   i. The sponsor has a sound track reecord and general reputation of fairness and integrity in all his business transactions for not less than 5 years.
   ii. The sponsor has contributed atleast 40% of the worth of AMC.
   iii. A trustee has been appointed by the sponsers who will act as trustee for the mutual fund.
   iv. An AMC is appointed to manage and operate the scheme of such funds.
   v. A custodian is appointed to keep custody of the securities and carry out the custodian activities.

c. Grant of certificate of registration.

d. Annual fee.

2. **The trustees:** SEBI(mutual fund) Amendment regulations. 1999 defines trustee as "a person who holds the property of the mutual fund in trust for benefit of the unit-holders and includes a trustee company and the directors of the trustee company." SEBI (mutual fund) regulatons, 1996 from 16to 18 contain guidelines with regard to operation of trustees

3. **Asset management company (AMC):**

   SEBI regulations require that mutual funds be managed by a seperate body corporate. The sponsor or the trustee shall appoint an AMC. The application for the approval of AMC has to be made in Form D. The appointment of AMC can be terminated by majority of the trustees or by 75% of the unit-holders of the scheme. Any change in the appointment of AMC requires the prior approval of the Board and the unit-holders.

4. **Custodian:** custodian is defined under SEBI (mutual funds) Regulations.1996 as " a person who has been granted a certificate of registration to carry on the business of custodian of securities under the securities and Exchange Board of India (custodian of securities) Regulations, 1996. Custodian provides custodial services and ensures safe-keeping of securities. He performs the following functions.

   i. Maintains accounts of securities of a client.
   ii. Collects the benefits or rights accuring to the client in respect of secutities.
   iii. Maintains and reconciles the records of securities.
   iv. Helps in transfer of the securities in the name of trust.
   v. Prevents any manipulation of records and documents.

   The following are the SEBI regulations with regard to custodian.

   Appointment of custodian (SEBI Regulation 26)

   i. The mutual fund shall appoint a custodian to carry out the custodian services for the schemes of the fund and sent intimation of the same to the board within fifteen days of the appointment of the custodian.
   ii. No custodian in which the sponsor or its associates holds 50% or more of the voting rights of the share capital of the custodian or where 50 % or more of the directors of the custodian represent the interest of the sponsor or its associates, shall act as custodian for a mutual fund constitutes by the same sponsor or any of its associate or subsidiary company.

CHAPTER-6

Primary Market

Features of New Issue Market

1. It is the market for new long term capital.
2. The securities are issued by company for the first time directly to the investors.
3. On receiving the money from new issues, the comany will issue the security certificates to the investors.
4. The amount obtained by the company after the new issues are utilized for expansion of the present business or for setting up new ventures.
5. External finance for long term such as loan from financial institutions is not included in new issue market. There is an option called “going public” in which the borrowers in new issue market raise capital for converting private capital into public capital.
6. The financial assests sold can be redeemed by the orginial holder of security.

Function of New Issue Market

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

- **Origination:** It refers to the work of investigation, analysis and processing of new project proposals.this function is done by merchant bankers who may be commercial banks, all India financial institutions or private firms.the success of the issue depends to a large extent on the efficiency of the market.
- **Underwriting:** It is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue.underwriting is a guarantee for marketability of shares. There are two types of underwriters in India- Institutional (LIC,UTI, IDBI,ICICI) and Non- institutional are brokers.

- **Distribution:** It is the function of sale of securities to ultimate investors. This is performed by specialized agencies like brokers and agents who maintain a regular and direct contact with the ultimate investors.

Role of New Issue/ Primary Market

- **Capital Formation:** It provides attractive issue to the potential investors and with this company can raise capital at lower costs.
- **Liquidity:** As the securities issued in primary market can be immediately sold in secondary market. The rate of liquidity of securities is higher.
- **Diversification of Risk**: Many financial intermediaries invest in primary market, as ther e is less risk of failure in investment as the company does not depend on a single investor.it reduces the overall risk.
- **Reduction in Cost:** Prospectus containing all details about securities are given to the investors.

SEBI Guidelines for Issue of Securities

The guidelines were first issued on 11th June 1992 and were amended subsequently from time to time. SEBI has now issued consolidated guidelines as SEBI (Disclosure and investor protection) Guidelines, 2000 vide its circular No . 1 dated 19-01-2000. These guidelines shall be applicabe to all public issues by listed and unlisted companies all offers for sale and rights issues by listed companies whose equity share capitalis listed, except in case of rights issues where the aggregate value of securities offered does not exceed 50 lacs. Broadly there are three methods for issuing securities to the public.

1. Conventional mode of receiving applications through bankers.
2. Book buildng.
3. On line system of stock exchange (e-IPO).

Primary Market Intermediaries

The major intermediaries of the primary securities market include:

- **Merchant Bankers/ Lead Managers** : Merchant bank is an institutiton or an organisation which provides a number of services including management of securities issues, portfolio management services, underwriting of capital issues, insurance, credit syndication, financia advices and project counselling etc. They mainly offer financial services for a fee.
- **Underwriters:** Underwriting is an act of undertaking the guarantee by an underwriter of buying the shares or debentures placed before the public in the event of non-subscribution. According to SEBI Rules 1993, underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them. "underwriter" means a person who engages in the business of underwriting of an issue of securities of a body corporate.
- **Bankers to an Issue**: Bankers to an issue is an important intermediary who accepts applications and application monies, collects all monies, refund application monies after allotment and participates in the payment of dividends by companies. No person can act as a banker to an issue without obtaining a certificate of registration from SEBI. Registration is granted by SEBI after it is satisfied that the applicant possesses the necessary infrastructure, communication and data processing facilities and requisite manpower to discharge its duties effectively.
- **Registrars to an Issue & Share Transfer Agent :** The Registrar to an issue is an intermediary who performs the functions of:
    1. Collecting applications from investors.
    2. Keeping a record of applications.

3. Keeping a record of money received from investors or paid to sellers of shares.
4. Assisting the companies in the determination of basis of allotment of shares.
5. Helping in despatch of allotment letter refund orders, share certificates etc..

- **Debenture trustees :** The Regulations define a debenture trustee as a trustee of a trust deed for securing any issue of debentures of a body corporate. Trust deed means a deed executed by the company in favour of trustees named therein for the benefit of the debentureholders. Only the folowing categories of persons are eligible to act as debenture trustees.

1. A scheduled bank carrying on commercial activity. Or
2. A public financial institution within the meaning of section 4A of the companies Acts. Or
3. An insurance company. Or
4. A body corporate.

The debebture trustee performs following duties:

1. Call for periodic reports from the body corporate.
2. Carry out inspection of books of accounts/ records/documents and registers and trust property.
3. Take possession of property as per provisions of the deed.
4. Enforce security in the interest of debenture holders.
5. Resolve grievences of debenture holders with respect to receipt of certificates, interest and other dues.
6. Exercise due diligence to ensure that the property secured is sufficient to pay the dues.

7. Ensures that provisions of the relevant laws are adhered to by the body corporate.
8. Carryout such as may be necessary for the protection of interest of debenture holders.

- **Brokers to an issue:** The person who procure subscriptions to issue from prospective investors spread over large area. A company can appoint as many number of brokers as it wants. Members are prohibited from acting as managers or brokers to issue by SEBI regulations.
- **Portfolio managers**.

Advantages of New Issue/ Primary Market

1. Mobilisation of savings.
2. Chanelizing savings for productive use.
3. Source of large supply of funds.
4. Rapid industrial growth.

Disadvantages of New Issue/ Primary Market

1. Possibility of deceiving investors.
2. No fixed norms for project appraisal.
3. Ineffective role of merchant bankers.
4. Lack of confidence among investors.

CHAPTER-7

Secondary Market or Stock Market

Stock market represents the secondary market where existing securities are traded. Stock exchanges are organised and regulated markets for various securities issued by corporate sector and other institutions.

Definition

- As per Hartely withers, " a stock exchange is something like a vast warehouse where securities are taken away from the shelves and sold across the countries at a fixed price in a catalogue which is called the official list".
- Husband and Dockery-" securities or stock exchanges are privately organised markets which are used to facilitate trading in securities"

Characteristics

Salient features of stoc exchange are:

- It is a place where securites are purchased and sold.
- A stock exchange is an association of persons whether incorporated or not.
- The trading in a stoc exchange is strictly regulated.
- Both genuine investors and speculators buy and sell shares.
- The securities of corporations, trusts, governments, municipal corporations etc. are both allowed to be dealt at stock exchange.

Functions of Stock Exchange

1. Ensure liquidity of capital.
2. Regular market for securities.
3. Evaluation of securities.
4. Mobilising surplus savings.
5. Helpful in raising new capital.
6. Safety in dealing.

7. Listing of securities.
8. Platform for public dept.
9. Clearing house of business information.
10. Smoothens the price movements.
11. Investors protection.

Benefits Of Stock Exchanges

The stock exchanges provides a number of useful services to investors, cmpanies and the community at large. These are as follows.

1. **Benefits to the Investors.**
   I. Ensures diversification of investment and risks by providing liquidity of investment.
   II. Imparts negotiability to securities which in turn helps investors to raise loans by pledging their holdings as collateral security.
   III. Assures safety and fair dealing.
   IV. Gives at all times knowledge of the true value of their investment through stock exchange quotations.
   V. Minimises risks of investment in industry by facilitating quick disposal of securities, at all times.
   VI. Educates prospective investors with the advertising influence of publicity of its transactions and enables them to make a rational choice among competing securities.
2. **Benefits to the company.**
   I. Enhances the credit standing of the company as the listing of its securities gives an impression of being a sound concern.
   II. Widens the market for the listed securities.

III. Reduces the danger of group opposition to management by enhancing marketability to the company's securities which in turn diversifies ownership.

IV. Minimises the risk of the new issue remaining unsold by enhancing the response to public issue of shares.

V. Minimises price fluctuations of securities that are listed and thus enhances the confidence of one and all dealing with it.

VI. Enables the company to command better bargaining power during amalgamation or merger.

VII. Enables the company to enjoy several tax advantages.

3. **Benefits to the Community**.

I. Stimulates investment in industry, public savings andensures a steady flow of capital into productive enterprises.

II. Helps the government in raising necessary finance from public for this purpose.

III. Assists in the best utilization of capital and in minimizing the waste of scarce capital resources.

IV. Smoothens the process of capital formation.

V. Reflects business conditions.

Organisation of Stock Exchanges in India

Stock exchange in India are organised in any of the following forms:

a) Voluntary, non-profit making associations, eg. Bombay, Ahmedabad and Indore.
b) Public Limited Companies such as Calcutta, Delhi and Bangalore stock exchanges, and
c) Company Limited by guarantee, eg, Hyderabad and Madras stock exchanges.

Management

A stock exchange is managed by a governing body which consists of a President, Vice-president, Executive Director, elected directors, public representatives and government nominees.

Regulation (SCRA)

In order to regulate the functioning of the stock exchange and to protect the interest of investors, securities contracts (regulation) act (SCRA) was passed in 1956. It became operation in February 1957. The main objective of the SCRA is to prevent malpractices in dealing of securities by regulating the purchase and sale of securities outside the boundaries of stock exchanges through the licensing of security dealers. The Act empowers the central Government and most of these powers have been delegated to SEBI.

SEBI's power in relation to stock exchange

The SEBI ordinance has given it the following powers:

I. It may call periodical return from stock exchange.
II. It has the power to prescribe maintenance of certain documents by the stock exchange.
III. SEBI may call upon the exchange or any member to furnish explanation or information relating to the affairs of the stock exchange or any members.
IV. It has power to approve bye-laws of the stock exchange for regulation and control of the contracts.
V. It can amend bye-laws of stock exchange.
VI. In certain areas it can licence the dealers in securities.
VII. It can compel a public company to list its shares.

Major Stock Exchanges In India

Bombay Stock Exchange (BSE)

Bombay stock exchange was established in 1875 as a voluntary non-profit making association at Mumbai. It is Asia's oldest stock exchange and is a major stock exchanges in India.

Management

A Governing Board comprising of 9 elected directors (one-third to retire every year by rotation) an Executive Director, three Government nominees , a Reserve Bank of India nominee and 5 public nominees regulate the working of the exchange. The executive director acts as the Chief Executive Officer and is responsible for the day to day administration of the exchange.

Working

Bombay Stock exchange allows following category of persons for trading:

I. The commission broker.
II. The floor broker.
III. The tarawaniwala, akin to a jobber or specialist.
IV. The dealer in non-cleared securities.
V. The odd-lot dealer.
VI. The dealer in foreign securities or arbitrageur.
VII. The security dealer or dealer in government securities.

On striking a deal, traders enter appropriate details in small boos called "souda books". SEBI has allowed BSE to extend its trading terminals to outside centres and the Bombay Online Trading System (BOLT) has enabled it to open trade working stations all over the country.

National Stock Exchange (NSE)

National Stock Exchange was incorporated in November 1992 with an equity capital of 25 crores.NSE is professionally managed national market for shares, PSU bonds, debentures and government securities with all the necessary infrastructure and trading facilites.NSE is an electronic screen based system where members have equal access and equal opportunity of trade irrespective of their location.

Objectives of NSE

The folowing are the objectives of NSE:

I. Providing a national wide trading facility for equities, debt instruments etc.
II. Ensure equal access to investors all over the country through an appropriate communication network.
III. Provide fair, efficient and transparent securities market to investors using electronic trading systems.
IV. Enable shorter settlement cycles and book entry settlement system.
V. Attain current international standards of securities market.

Working

The settlement cycle is completed within eight days from the last day of the trading cycle. The trading period is a week (Wednesday to Tuesday) and settlement of trade takes place in the ensuing week.

Over the Counter Exchange of India (OTCEI)

It was established in october 1990, with an objective to provide an alternative market for securities of smaller companies.this exchange has been jointly promoted by UTI, ICICI, IDIB, SBI Capital Markets Ltd. IFCI, GIC and Canbank Financial services Ltd.The following arethe main features of OTCEI.

1. It is ringless and electronic national exchange.
2. It caters the need of the small business which have so far not met the requirements for listing on the stock exchange.
3. This exchange has a nation wide reach.
4. Small and medium sized companies with a paid up capital between 30 lakhs and 25 crores can be enlisted.

OTCEI deals in equity shares, preference shares, bonds, debentures, warrents.

5. The trading is by way of negotiated bidding.
6. The tranactions take place through satellite communication telephone lines.
7. A company which is listed on any other recognised stock exchange in India will not simultaneously be eligible for listing on the OTCEI.

Advantages of OTCEI

This exchange has the following advantages:

1. There is a transparency in transactions.
2. The liquidity is ensured and a transaction is normally completed in 7 days.
3. A proper scrutiny is done of the scrips by the sponsors.
4. A company needing immediate funds can pledge its equity with the sponsor and there by reduce interest cost.
5. A small company at one gets nationalwide listing.
6. The companies listed on OTCEI are subjected to low income tax.

Trading In Stock Markets

There are two basis ways of trading at stock exchanges

I. Trading on the exchange floor: The buying and selling at stock exchanges is not allowed to outsiders.they have to approach brokers who are members of the exchange and dealings can only be through them. The following procedure is followed for dealing at exchange:
    I. Selection of a broker.
    II. Placing an order.
    III. Making the contract.
    IV. Contact note.
    V. Settlement. The settlement for ready delievery and forward contracts is done with a different procedure.

I. Settlement of ready delivery contracts: The settlement in diferent stock exchange is done between 3 to 7 days of the transaction. If the settlement is done by giving actual delivery of securities on receiving the price it is called liquidation in full.

II. Settlement of forward delievery contracts:the forward delievery contracts are done for speculative purposes. Only the active and broad market securities are traded n forward contracts. Settlement of forward contracts can be done in any of the three ways,

a) Liquidation in full.
b) Liquidation by payment ofdifference.
c) Carry over to the next settlement. The buyer will have to pay certain amount to the seller for this concession and the amount paid is known as “Badla” or Contago charge”

Rolling Settlement

It is an important measure to enhance the efficiency and integrity of the security market. In January 1998 SEBI has introduced rolling settlement on a voluntary basis on the stock exchanges for securities which were eligible for dematerialised trading. Rolling settlement has been introduced the form of T + 5 settlement system where T is the trade date and 5 days are given for delievery of securities and cash cash payments.

Advantages of Rolling Settlement

- Rolling settlement system eliminates any scope for speculaton and arbitrage.
- RS system is simple to understand as cmpared to Badla system. It is more transparent and regulated.
- RS reduces the period of settlement of transactions.
- There is no risk of fluctuations of prices.

- RS ensures standardised settlement process.
- Retail investors are at more advantageous position because RS shortens the delays for converting securities into cash.

The success of rolling system depends upon depository, margin trading , strong banking system with electronic fund transfer facility and continuous net settlement of transactions. Stock markets moved from T + 5 to the T + 2 system from april 1 2003 and further moved to T + 1 system.

2 **ELECTRONIC TRADING**

The individual investor can get insistent confirmation of his trade in the electronic trading system. It also facilitates online investing by bringing investor closer to the market. The advantage of electronic trading is that it brings more transparency by displaying all buy and sell orders in the trading system. The types of transactions that are usually carried out on the indian stock exchanges include.

I. Spot delivery transactions.
II. Future and forward transactions.

BUYING AND SELLING OF SECURITIES

Stock transaction takes place in three major steps:

1. Placing order (buy or sell) online: there are two methods for placing orders.
    - Online stock trading: The online trading is done by self. For online trading you need computer, internet connection, demat and trading account.
    - Offline stock trading: The order will be placed by the broker on behalf of the buyer. The buyer doesn’t need any computer and internet connection.
2. The order goes to the broker (like India Bulls, ICICI direct etc.)
3. From broker the order goes to stock exchange (either BSE or NSE) and finally based on offer price the order get executed.

ONLINE STOCK TRADING

Online stock trading is a facility based on trading of the stocks. The investors can easily trade the shares by means of an online website devoid of any labor-intensive interference from the stock brokers. BSE and NSE are the two exchanges in which most of the companies of online stock trading India deal in. There are two different types of trading platforms available for online equity trading.

a) Installable software based stock trading terminals: these trading terminals require software to be installed on investors computer, and are provided by stock broker.these software require high speed internet connections.

ADVANTAGES

1. Orders are directly sent to stock exchanges rather than stock broker. These makes order execution very fast.
2. It provides almost each and every information which is required by a trader on a single screen including stock market charts, live data, alerts, stock market news etc.

DISADVANTAGES

1. Location constraint.
2. It requires high speed internet connection.
3. These trading terminals are not easily available for low volume share traders.

b) *WEB (INTERNET) BASED TRADING APPLICATION*

They are like other internet websites which investor can access from around the world through normal internet connection.

ADVANTAGES OF ONLINE STOCK MARKET TRADING

1. It helps in real time stock trading without calling or visiting broker's office.
2. It displays real time market watch, historical data, graphs etc.
3. It makes easy to invest in IPOs, mutual funds and bonds.
4. One can check demat account balance and bank account balance at any time.

5. It offers customer service through Email or chat.
6. It secures transactions
7. It provides online tools like market watch, graphs and recommendations to do analysis of stocks.

DISADVANTAGES OF ONLINE STOCK TRADING

1. The procedure of online stock trading in India is a bit long-learning procedure for those who are not aware about the internet and computer technology.
2. Sometimes the site is very slow and is not enough user friendly.
3. Brokerages are little high.

If one wants to invest in share market through online trading he needs to have three things:

1. Money.
2. Demat account.
3. Online trading account.

PROCEDURE OF ONLINE TRADING

1. Log on to the stock brokers website.
2. Register as client/ investor.
3. Fill in application form and client broker agreement form on the requisite value stamp paper.
4. Obtain user ID and password.
5. Log on to the broker's site.
6. Market watch page will show real time online market data.
7. Trade shares directly by entering the symbol of the security.
8. Broker's server will check your limit in the online account and demat account for the number of shares and executes the trade.
9. Order is executed instantly and confirmation can be obtained.
10. Confirmation is e-mailed to investor by the broker.
11. Contract note is printed and mailed in 24 hours.
12. Settlement will take place automatically on the settlement day.
13. Demat account and bank account will get debited and credited by electronic means.

WEAKNESSES OF STOCK EXCHANGES IN INDIA

Principal weaknesses are discussed as follows:

1. Lack of professionalism.
2. Domination of financial institutions.
3. Poor liquidity.
4. Domination by big operators.
5. Less floating stocks.
6. Speculative trading.

STEPS TO IMPROVE WORKING OF STOCK EXCHANGES

1. Stock exchange asked to modify the listing agreement to provide for payment of interest by companies to investor from 30the day after the closure of a public issue.
2. Uniform good –bad delievery norms and procedure for time bound resolution of bad delieveries through bad delievery cells prescribed.
3. All exchanges to institute the buy-in or auction procedure being followed by the National Stock Exchange.
4. Study groups constituted to make recommendations for imparting greater transparency and fairness in bulk of negotiated deals.
5. Stock Exchanges asked to set up a clearing house or clearing corporation.
6. Stock Exchange disallowed from renewing contracts in cash group of shares from one settlement to another.
7. A core group of inter-exchange market surveillance set up for coordinating action in case of abnormal volatility.
8. A stock lending scheme has been introduced. The approved intermediary should have a minimum net worth of 50 crore.

MAJOR INTERNATIONAL STOCK MARKET

The following is the list of top 5 international stock exchanges on the basis of market capitalization as on 31 january 2015.

NEW YORK STOCK EXCHANGE (NYSE)

It is an American stock exchange. It was founded on 17th may 1972. It is located at 11 wall street, lower manhatten, newyork city, united states. Its trading floor is located at 11 wall street and is composed of 21 rooms used for the facilitation of trading.

FEATURES

1. It is the world’s largest stock exchange by market capitalization of its listed companies at US$ 19233 billion as of 31th january 2015.
2. The average daily trading value was approximately US$ 19 billion in 2013.
3. The number of listings as on may,2015 were 1868.
4. The NYSE is owned by Intercontinental Exchange, an Amercian holding company.
5. The New york stock exchange also referred to as “the BIG BOARD”.
6. THE NYSE is open for trading Monday through Friday with the exception of holidays declared by the Exchange in advance.
7. The NYSE trades in a continuous auction format where traders can execute stock transactions on behalf of investors.
8. The NYSE opening bell in rung at 9.30 AM ET to mark the start of the day’s trading session. At 4 PM ET the closing bell id rung and trading for the day stops.
9. The majo indices are Dow jones Industrial average, standard & poor 500, and NYSE composite.
10. Its official website is NYSE.com.

NASDAQ

It is an American stock exchange behind only the New york stock exchange. It stood for National Association Of Securities Dealers Automated Quotations. It was founded on february 4,1971 and it began trading on February 8, 1971. It is located at Liberty plaza 165 Broadway, Newyork city, united states.

FEATURES

1. It was the world first electronic screen based equity securities trading market in the united states.
2. It is the second largest exchange in the world by market capitalization of 6831 US$ billion as on 31th January 2015.
3. The number of listings as on july, 2015 were 3058.
4. Its main index is the NASDAQ Composite.
5. The small order execution system (SOES) Provides an electronic method for dealers to enter their trades.
6. NASDAQ has a pre-market session from 4 AM To 9.30 AM eastern, a normal trading session from 9.30 AM to 4.00 PM and a post market session from 4.00 PM to 8.00 PM.
7. Its official website is Nasdaq.com.
8. The NASDAQ has had an average annualized growth rate of 9.24 % as of June 2015.
9. The status of NASDAQ was changed from stock market to a licensed national securities exchange in 2006.

REQUIREMENTS FOR LISTING

1. Be registered with the united States Securities and Exchange Commission.(SEC).
2. Have atleast three market makers.

3. Meet minimum requirements for assets, capital,public shares and shareholders.

LONDON STOCK EXCHANGE GROUP (LSEG)

It is a British based stock exchange and financial information company. Its head quarter is located at 10 paternoster square, city of london, England, United Kingdom. It is a pblic limited company rendering financial services. It was founded in 2007.

It owns the London Stock Exchange, the Borsa Italiana, Millennium IT and Russell investments.

- The London Stock Exchange is Europe’s leading stock exchange. It was founded in London in 1801. The exchange moved to a new purpose building and trading floor in Thread needle sreet IN 1972.
- The Borsa Italiana is Italy’s leading stock exchange.
- MillenniumIT was acquired by LSEG in 2009 as their technology service provider.it is offering world’s fastest trading platform known as Millennium Exchange for most of leading stock markets in the world.
- Russell Investments was one of the largest providers if Index services.

FEATURES

1. It is the third largest exchange in the world by market capitalization of 6187 US$ billion as on january 2015.
2. London stock Exchange Group owns 100% shares in the index company FTSE group.
3. Its official wedsite is LSEG.com

JAPAN EXCHANGE GROUP,INC. (JPX)

It is an Asian financial services corporaton, its headquarter is at kabutocho, chuo, Tokyo, Japan. It operates multiple securities exchange including Tokyo stock Exchange (TSE) and Osaka Securities Exchange (OSE).

FEATURES

1. It was formed bt rhe merger of the two companies TSE and OSE on january 1, 2013.
2. It is the Asia's largest bourse having market capitalization of US$4485 billion as on 31th january, 2015.
3. On january 4, 2013 JPX Was listed at TSE's first section (8697). JPX also assumed OSE's own ticker symbol (also 8697).
4. Its subsidiaries include Tokyo stock exchange, Osaka Securities Exchange, Japan Exchange Regulation and Japan Securities Clearing Corporation.
5. Its official website is jpx.co.jp/

SHANGHAI STOCK EXCHANGE (SSE)

It is based in the city of shanghai, china. It is a non profit organisation directly administered bt the China Securities Regulatory Commission(CSRC).

FEATURES

1. It has a market capitalization at US$3968 billions as of january 2015, and second largest in east Asia and Asia.
2. The Shanghai stock exchange is not entirely open to foreign investors due to tight capital account controls exercised by the chinese mainland authorities.
3. The current exchange was re established on November 26, 1990 after a 41 year hiatus and was in operation on December 19 of the same year.
4. The number of listings as on May 2015 were 1041.
5. Its major indices include SSE composite and SSE 50.
6. It provides securities for financial market participants, efficient clearing services and development purposes.
7. Its official websie is www.sse.com.cn and english.sse.com.cn

CHAPTER-8

Markets For Derivatives

Derivatives are so called because they are financial instruments whose value is derived from the value of an underlying financial instrument (a treasury bill, a bond or a note) or an individual equity or an equity index or an interest rate or a commodity (e.g.gold) or credit risk. The primitive and simplest form of derivatives is the forward contract (also known as the forefather of the derivatives). We have financial derivatives (e.g.forwards, futures, options, swaps or mix of these), equity derivatives, commodity derivatives, interest rate options and swaps, credit derivatives etc. derivatives have become very common due to the gradual liberalisation, globalisation of business and securities markets all ovr the world in recent years.

FUNCTIONS OF DERIVATIVES

The primary function of the derivatives is to transfer price risks associated with fluctuation in assests values. The derivative provide three important econmic functions.

- Risk management
- Price discovery.
- Transactional efficiency.

PLAYERS IN DERIVATIVE MARKET

There are three major players in the derivatives market.

1. **Hedgers :** hedgers include,
    - The marginal players who take an exposure and therefore want protection.
    - Traders who trade in products and are therefore exposed to risk and want protection. Hedgers seek to protect themselves against price changes in a commodity in which they have an interest.

2. **Speculators**: In any market prices move up and down depending upon the demand for and supply of the goods but in a competitive market it also moves based on the ability of the players to predict the movements and their risk apetite. These players are called speculators.speculators are prepared to assume risk in return for quick and large profits.
3. **Arbitrageurs:** The arbitrageurs look for opportunities for market money out of price mismatches in two different markets. They are specialised in making purchases and sales in different markets at the same time and profis by the difference in prices between the two centres.

TYPES OF DERIVATIVES

The commonly used derivatives can be caegorised into following three broad categories.

1. **OPTIONS:** An option is a contract conveying the right but not obligation to buy or sell specified financial instruments at a fixed price before or at a certain future date.there are two parties in options in which the buyer receives a right for which he pays a fee called premium and the seller undertakes an obligation. A person who buys the option is said to be long in option and the other who sells is said to be short.

FEATURES OF OPTIONS.

- Only the buyer or the owner has the right to exercise the option.
- The buyer has limited liability.
- An option is created only when two parties. i.e, a buyer and a writer/ seller, strike a deal.
- Option holders do not carry any voting right and are not entitled to receive any dividend or interest payment.
- Options have high degree of risk to the option writers/sellers.

- Options allow the buyer to earn profit from favourable market conditions.
- Options provide flexibility to the investors (buyers) who have every right to either purchase or sell before or at a certain future date.
- No certificates are issued by the company.

STYLES OF OPTIONS

Options are traded basically in three styles:

a) American style option: It can be exercised by the holder of the option any time between the purchase date and expiration date.

b) European style option: It can be exercised only on the expiration date by the holder of the option. The expiry and the exercise date coincides with each other.

c) Capped options: It has a predetermined cap price which is below the strike price for a put option and above the strike price for a call option.

COMPONENTS OF OPTIONS

There are two components of options.

1. **Call Option**: The owner/ buyer has the right to purchase and the writer/seller has the obligation to sell specified number of securities of the underlying stocks at a specified price prior to the option expiry date. A call option when it is written against the assest owned by the option writer is called a covered option, and the one written without owing the asest is called naked option.

   The value of call option ar expiration= Maximum [share price- Exercise price,o]. i.e. maximum of share price – Exercise price or zero.

2. **Put Option:** The owner or buyer has the right to sell and the writer/ seller has the obligation to buy specified number of the underlying shares at a specified price prior to the expiry date of option. The profit of put option buyer is limited since the share price cannot fall below zero.

   Value of put option at expiration= Maximum[Exercise price- Share price.0]

KINDS OF OPTION VALUATION

The following three situations may arise:

1) **In The Money**: If the current market price of the underlying assest exceeds the exercise price in case of a call option or if the current market price falls below the strike price in case of a put option, the option is said to be in the money.
2) **Out Of Money:** If the current market price of the underlying assest is less than the exercise price of a call option or if the current market price of underlying assests is more than the said price in case of a put option the option is said to be out of money.
3) **At The Money**: The at the money situation arises when the exercise price is equal to the current market price of the underlying assest.

PLAYERS IN THE OPTIONS MARKET

The following are the players in the optional market.

1. Development institutions.
2. Mutual funds.
3. Domestic and foreign institutional investors.
4. Brokers.
5. Retail investors.

WAYS TO LIQUIDATING AN OPTION

An option can be liquidated in three ways.

- Buying and selling.
- Exercising.
- Abandonment.

ADVANTAGES TO THE INVESTORS.

Investors choose to trade an options because number of advantages accure to them.

1. Protection against risks.
2. Known limited risk.
3. Wider investment choice.
4. Leveraged speculation.
5. Reduced cost
6. Arbitrage.
7. Large profit potential.

CHAPTER-9

Provident Fund, Pension Funds, PFRDA, Insurance Companies and IRDA

PROVIDENT FUND

A provident fund is created with the purpose of providing financial security and stability in old age. Generally one contributes in these funds when one joins as employee. The contributions are made on a monthly basis regularly. The main purpose is to help employees save a part of their salary every month to be used at retirement or in an event that the employee is temporarily unfit or no longer fit to work. The investments made by a number of people/ employees are poled together and invested by a trust. In india there are following types of provident funds, namely.

1. NON-CONTRIBUTORY PROVIDENT FUNDS OR GPF: These are more commonly known as General Provident Fund. These general provident funds are governed by the GPF Act 1925 and GPF Rules (central services) Rules1960. These funds are generally meant for central and state government employees. Contributions to these funds are solely by employees.
2. CONTRIBUTORY PROVIDENT FUND OR EPF: It is applicable to the industrial workers and not to those working in government sector. Both the employer as well as employees contributes to these funds and the accumulated amount along with interest ispaid to employees in the event of their death or when they exist from service.
3. PUBLIC PROVIDENT FUND ACCOUNT: It is a tax free savings investment that was introduced by the Ministry of Finance in India in the year 1968. PPF scheme is one of the most tax efficient instruments in India because deposits made towards PPF accounts can be claimed as tax deductions. It was launched to encourage savings amoung Indians in general

and to provide financial stability in old age in particular.individuals who are residents of india are eligible to open their account under the Public Provident Fund.

FEATURES

- Interest rate: Interest earned on deposits in the PPF accounts are not taxable.
- Tenure: 15 years account continuance is allowed beyond maturity for 5 years at every renewal with or without making additional deposits.
- Annual deposit amount: Rs.500 to Rs.1.5 lakhs per year.
- Deposit frequency: A deposit has to be made every year for 15 year to keep the amount active.
- Withdrawals: Partial premature withdrawals can be made every year from 7th year withdrawals are subjected to conditions.
- Tax advantages: Deposit amount are tax deductible U/S 80 C of the income tax Act withdrawals are exempted from wealth tax.
- Nomination: Allowed on opening the account or after.
- Fund transfer: Funds /accounts cannot be transferred between people but can be easily transferred between bank branches or post offices for free.
- Loan facility: Loans can be availed against funds held in the PPF account from year 3 to year 6.
- Renewal: Renewal or extention of the scheme is allowed for an extra 5 years at a time.
- Joint account: Not allowed.

ADVANTAGES OF PPF

- These accounts serve long term investment goals.
- Effective returns tend to be more attractive as compared to bank FDs.

- Tax free returns and capital protection make this an ideal option for building a retirement corpus.
- Tax free interest and withdrawals and tax deductible investments are the major attractions.
- Being government backed there is low risk of defaults.
- PPF accounts can be opened at any Nationalised ,Public sector banks or post offices and select private banks, all of which have wide reach.

EMPLOYEES PROVIDENT FUND ORGANISATION (EPFO)

The employee and employers contribution is maintained by the employees provident fund Organisaion (EPFO). It administers a compulsory contributory Provident Fund Scheme, Pension Scheme and an Insurance Scheme.the headquarters of EPFO is in New Delhi.

CHARACTERISTICS OF EPFO

1.The Employee's Provident Fund Organisation (EPFO) is a statutory body of the Government of India under the ministry of Labour and Employment.

2. It is also the nodal agency for implementing Bilateral Social Security Agreements with other countries on a reciprocal basis.

3. The schemes cover Indian workers as well as International Workers.

4. it is one of the largest social security organisations in India in terms of the number of covered beneficiaries and the volume of financial transactions undertaken.

5. the EPFO's apex decision making body is the Central Board of Trustees (CBT) .CBT are composed of representatives of employers and employees the Government of India and provincial government.

6. the total assests under management are more than 8.5 lakh crore as on 18 March 2016.

ROLE OF EPFO

- The EPFO act as the enforcement agency to oversee the implementation of the EPF and MP Act and
- EPFO also act as a service provider for the covered beneficiaries throughout the country.

POWERS OF COMMISSIONERS OF EPFO

The commissioners of the EPFO are vested with vast powers under the statue conferring quasi-judicial authority to-

- Search and seizure of records.
- Assess financial liability on the employer.
- Levy of damages.
- Attach and auction of a defaulter's property.
- Prosecution and arrest and detection in civil prison.

ORGANISATION STRUCTURE

1. The EPFO is organised into zones which are headed by an Additional Central Provident Fund Commissioner for each of the states.
2. The states have either one or more than one Regional Offices headed by Regional Provident Fund Commissioners(RPFC)grade 1.
3. Regions are further sub-divided into sub-regions headed by Regional Provident Fund commissioners (grade 2).
4. Assistant Provident Fund Commissioners assist RPFC's.
5. At district level an Enforcement Officer is stationed to inspect the local establishments and attend to grievances.

RECRUITMENT

1. The commissioner cadre officiers are recruited directly through the Union Public Service Commission (UPSC) competitive exams as well as through promotion from lower ranks.

2. Subordinate officiers are also recruited directly in addition to promotion from the staff cadre of social security assistants.
3. The total manpower of the EPFO is at present more than 20000 including all levels.

UNIVERSAL ACCOUNT NUMBER (UAN)

On 1 october 2014 Prime Minister of India sh. Narendra Modi launched universal account number for Employees covered by EPFO to enable PF number portability.

1. The UAN is a 12 digit number allotted to each employee who is contributing to EPF. It is generated for each of the provident fund Member by EPFO.
2. The UAN will act as an umbrella for the multiple member Ids alloted to an individual by different esablishment.
3. It remains same through the lifetime of an employee. It does not change with the change of jobs.

EPFO has now started to provide refund of Administrative charges if all the KYC details are updated for all employees. This incentive program is announced for the year 2016-2017.

IMPORTANCE OF PROVIDENT FUND SCHEMES

Provident funds occupy a significant place in Indian context because of the following reasons.

1. Encourage people to save regularly.
2. Provides a feeling of ownership and financial stability.
3. Act as a secured, definite financial reserve for the country.
4. Provides social securities to members and family.
5. Promotes the idea of self-help.
6. Simplicity and easy to administer.
7. Financial participation from government is not required.

LIMITED COVERAGE

1. Provident schemes cater to the industrial workers in the organised sector which constitute only 9.4 % of the total workforce. The unorganised sector which represents 90.6% of the total workforce is out of the coverage of the provident fund schemes.
2. Even all the regular salaried employed persons which constitute 15.2% of the workforce are not covered. Only 10.8% of the salaried employees have been covered.
3. Agriculture workers which constitutes 63.9% of the total workforce are out of the perview of the provident fund schemes except those employed in agriculture farms, orchards, gardens, tea, coffee, rubber, cardamom plantations etc.which are mainly in the organised sector.
4. Self employed which occupy 53.6% of the total workforce are also not covered by any of the provident fund schemes or pension schemes.
5. In the present era of globalisation/liberalisation these schemes do not provide for unemploynment benefits which are the need of the hour.