Chapter 1:- Basics of Indian Financial System

Meaning of Financial System:

Financial system is a set of inter-related activities or services working together to achieve some predetermined purpose or goal. It includes different markets, the institutions, instruments, services and mechanisms which influence the generation of savings, investment, capital formation and growth.

In other words, Financial system refers to all the securities, intermediaries, and markets that exist to make transfers from savers to borrowers possible.

Definition of Financial system:

According to **Robinson**, "Financial system is the primary function of the system which is to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth".

According to **S.B Gupta** "A set of institutional arrangements through which financial surpluses available in the economy are mobilized".

Features of Financial system:

1) It helps in allocation of funds.
2) It facilitates expansion of Financial markets.
3) It allows transfer of money between savers and borrowers.
4) It is a set of inter related activities or services.
5) It plays a vital role in economic development of a country.
6) It encourages both savings and investments.
7) It helps in bringing investments.
8) It helps to monitor corporate performance.
9) The main objective is to formulate capital, investment and profit generation.
10) It creates a bridge between investors and companies.

Objectives of Financial System:

1. **To mobilize the savings:-** The financial system begins its operations by mobilizing of savings from the small saving community. It collects the fund by offering different schemes which attract the investors to fund their savings in different institutions, services, securities etc.

2. **To distribute the savings for the industrial investment:-** The purpose of mobilizing the fund from the saving community is to invest them in different industries. Thereby it meets the fund requirement of industrial sector. Hence it helps in the growth of industrial sector.

3. **To stimulate capital formulation:-** The objective of supporting the industries is not ended with sanctioning of fund to them. Further, it makes them to formulate the capital out of their earnings for the further capital requirement and industrial investment.

4. **To accelerate the process of economic growth:-** The ultimate aim of the financial institutions is to support the process of economic growth of a nation. Directing the saving fund to the industrial capital need, Motivating them for the capital formation support the acceleration of the process of economic growth.

Functions of Financial System:

1. **Promotion of Liquidity:** The major function of the financial system is the provision of money and monetary assets for the production of goods and services. There should not be any shortage of money for productive ventures. In financial language, the money and monetary assets are referred to as liquidity. In other words, the liquidity refers to cash or money and other assets which can be converted into cash readily without loss. Hence, all activities in a financial system are related to liquidity – either provision of liquidity or trading in liquidity.

2. **Mobilization of Savings:** Another important activity of the financial system is to mobilize savings and channelize them into productive activities. The financial system should offer appropriate incentives to attract savings and make them available for more productive ventures. Thus, the financial system facilitates the transformation of savings into investment and consumption. The financial intermediaries have to play a dominant role in this activity.

3. **Risk Function:** The term risk and uncertainty can be defined as the probability of happening of an unexpected event due to which the investors may be under loss in future. Financial intermediaries enable the investors to diversify investments widely which help in reducing the risk of capital depreciation and poor dividends. Hence a combination of financial assets will help in maintaining risk.

4. **Lowers the cost of transactions:** A financial system helps in the creation of a financial structure that lowers the cost of transactions. This has a beneficial influence on the rate of returns to saver. It also reduces the cost of borrowings. Thus, the system generates an impulse among the people to save more.

5. **Payment function:** The financial system offers a very convenient mode for payment of goods and services. Cheque system, credit card system etc. are the earliest methods of payments. The cost and time of transactions are drastically reduced. It provides a payment

mechanism for the exchange of goods and services and transfers economic resources through time and across geographic regions and industries.

6. **Small savings to big investment:** Financial system acts as an intermediary in transforming the mobilized fund of saving to the big investments. It offers different credit schemes to the fund needy people to get fund from financial institutions for the investment objective. It channelizes small savings fund received from the saving group to the industries to investments.

7. **Pooling of Funds:** A financial system provides a mechanism for the pooling of funds to invest in large scale enterprises. Large corporate companies raises funds through bonds, debentures and public deposits to invest in large scale business enterprises.

8. **Information Function:** A function system makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.

9. **Transfer Function:** A financial system provides a mechanism for the transfer of the resources across geographic boundaries.

10. **Monitor Corporate Performance:** A financial system not only helps in selecting the projects to be funded but also motivates the various stakeholders of the financial system to monitor the performance of the investment. Financial markets and institutions help to monitor corporate performance and exert pressure on the corporates to continuously improve their performance.

Structure of Indian Financial system or components of Indian financial system.

1. Financial Institutions
2. Financial markets
3. Financial intermediaries
4. Financial services

1. **Financial Institutions:** Financial institutions are the intermediaries which facilitate smooth functioning of the financial system by making investors and borrowers meet. They mobilize savings of the surplus units and allocate them in productive activities promising a better rate of return.

Features of Financial Institutions:-

1) It is an intermediary as well as institution.
2) It channelizes savings fund into investment fund.
3) It creates financial assets such as Deposits, loans, securities etc.

4) It includes banking and non banking institutions.

5) It includes both organized and unorganized institutions.

Classification of Financial Institutions:-

1) **Banking Institutions:-** These are the type of financial institutions which involve in accepting public deposits and lending the same to the needy customers. These are fundamentally established to earn profit, secondarily to safeguard the interest of the members. They extend credit while lending money. Banking Institutions is further classified as :

a) **Commercial Banks:-** These are also called as Business Banks. The following are the types of commercial banks

i) Public Sector.

ii) Private sector.

iii) Regional Rural Banks.

iv) Foreign Banks.

b) **Co-operative Banks:-** These are established to safeguard the interest of its members. These are organized on a cooperative basis, accept deposit and lend money to the required members.

2) **Non-Banking Institutions:-** These are the financial Institutions that provide banking services without meeting the legal definition of a bank. The non-banking financial institutions also mobilize financial resources directly or indirectly from the people. They lend the financial resources. Companies like LIC, UTI, GIC, Development Financial Institutions, organisation of pension and provident funds etc. Fall in this category.

Functions of Financial Institutions:-

1) **Accepting Deposits:-** Most of the financial institutions accept deposits from the public. They offer different schemes to move up public deposits from the customers.

2) **Providing Commercial Loans:-** Accepted deposits are used for commercial lending operations in the form of loans, advances, cash credits, bill discounting etc. These fetch good return to the financial institutions.

3) **Providing Real Estate Loans:-** The financial institutions also provide loans and advances for real estate industries to purchase site, build premises, construction industrial and residential parks.

4) **Providing Mortgage loans:-** The financial institutions also provide loan to the needy group on mortgage of properties and collateral securities. For example, Gold loan, property loan etc where gold and properties are mortgaged to avail the loan.

5) **Issuing Share certificates:-** Financial Institutions also undertake the job of issuing share certificates of any established corporate to its shareholders. It also constitutes

accepting shares investment money from the investors and issuing them certificates on behalf of the companies.

6) **Act as an intermediary:-** Financial institutions act as an intermediary in between the savings community and industrialists. They receive the public deposit a lower rate of interest and lend the same fund to the needy group at higher rate of interest. The difference amount of interest is the profit for their intermediary work.

7) **Facilitate the flow of money:-** They also facilitate the flow/channelize the money to the investment activities. Financial institutions are the interlinked path stones to make smooth flow fund from small savers to giant business ventures.

2. **Financial markets:** It is a market in which people and entities can trade financial securities, commodities and other financial stocks at low transactions costs and at prices that reflect supply and demand.

   Financial market refers to any market place where buyers and sellers participate in trading of assets such as bonds, currencies, and other financial instruments.

Classifications of Financial Markets:-

1) **Unorganised Financial Markets:-** These are comprised with private money lenders, pawn brokers, indigenous bankers, traders etc. They lend money to the public from their own fund. The operations and activities of these are not regulated by RBI or by any other controlling authority.

2) **Organized Markets:** In the organized markets, there are standardized rules and regulations governing their financial dealings. There is also a high degree of institutionalization and instrumentalization. These markets are subject to strict supervision and control by the RBI or other regulatory bodies. These organized markets can be further classified into two.

They are

i. Capital Market

ii. Money Market.

a) **Capital Market:** The capital market is a market for financial assets which have a long or indefinite maturity. Generally, it deals with long term securities which have a maturity period of above one year.

b) **Money Market:** The money market is a market for financial assets which have a short or definite maturity. Generally it deals with short term securities which have a maturity period of below one year.

3. **Financial Instruments/Assets:** A financial asset is one, which is used for production or consumption or for further creation of assets. For instance, A buys equity shares and these shares are financial assets since they earn income in future.

Characteristics of Financial instruments:-

1) Financial instruments provide liquidity. These can be easily and quickly converted into cash.
2) Financial instruments facilitate easy trading on the market. They have a ready market.
3) Financial instruments can be pledged for getting loans.
4) Financial instruments can be transferred from one person to another.
5) The maturity period of financial instruments may be short term, medium term or long term.

Classification of Financial Instruments:-

1) **On the basis of Durability:-** These are the tradable financial assets and exchanged on term basis. These are again classified into short term, medium term and long term securities.

a) Short term securities:- this sub-category comprises with maturity of one year or less.

b) Medium Term Securities:- Basis for classifying securities under this sub-category depend on practices applied in financial markets of the given country. Normally, this sub-category includes securities with maturity from 1 to 5 years.

c) Long term securities:- This sub category comprises securities with maturity longer than those of short or medium term securities.

2) **On the basis of Category:-** Under this classification financial securities are classified into primary, secondary and innovative instruments.

a) Primary instruments:- They are defined as, " a financial instrument whose value is not derived from that of another instrument, but instead is determined directly by the market. Examples Equity shares, preference shares and debentures.

b) Secondary instruments:- A primary instrument is an instrument issued directly by the financial institutions to an investor. For example: Commercial papers, Certificate of deposits.

c) Innovative instruments:- These are the financial innovative instruments to suit the needs of corporates and investors group. Example Derivatives, Foreign currencies mortgages etc,.

4. Financial services: It refers to services which are financial in nature offered by financial industries to its customers. Its objective is to intermediate and facilitate financial transactions of individuals and institutional investors.

Classification of Financial services:

1. **Fee based Services**: Fee based financial services are those which are paid for a flat fee rather than commissions. Those services are known as fee based services.

Following are the fee based financial services:

1) Portfolio Management: - It is a method of managing and allocating funds on various best alternatives to reduce the uncertainity is known as portfolio management.
2) Loan syndication: - It is the process where large number of lenders contributes amount and grant loans to company or any project and share risk and returns of the same.
3) Corporate Counseling: - It refers to a set of activities performed to ensure the efficient running of a corporate enterprise and to improve the performance.
4) Foreign Collaboration: - It is an alliance in corporate to carry on agreed task collectively with the participation of resident and non-resident entities.

2. Fund based services: Fund based or asset based financial services are those services which are rendered for commission basis or for a certain amount of interest.

Following are the Fund based financial services:

1) Leasing: - It refers to a written agreement between lessor and lessee where lessor allows lessee to use his property for specified period of time or rent is called lease.
2) Factoring: - It is a facility provided by factor (Financial institution) to its clients (company), where as factor purchase debts and receivable accounts of the clients at discount rates and offers immediate cash. This facility is called as factoring. It is also called as account receivable finance.
3) Bills discounting: - Trading or selling bills to financial institution prior to its maturity period for discount rate is called discounting bill of exchange. The rate of discount depends on the time left before the bill mature and risk attached to it.
4) Venture capital: - It is a way of financing by investor to companies for its start up and to promote project. Investor joins entrepreneurs as co-promoter and share risk and returns.

Chapter 02:- Banking Institutions

Introduction:-

Banking institutions are the important segment in Indian Financial System. An efficient banking system helps the nation's economic development. Various categories of stakeholders of the society use the banks for their different requirements. Banking institutions are financial intermediaries between the depositors and the borrowers.

The Reserve Bank of India as the central Bank of the country plays different roles like the regulator, supervisor and facilitator of the Indian Banking System. Bank is an financial institution or intermediary institutions for various financial necessities and dealing either directly or indirectly with financial system, of nation's economy.

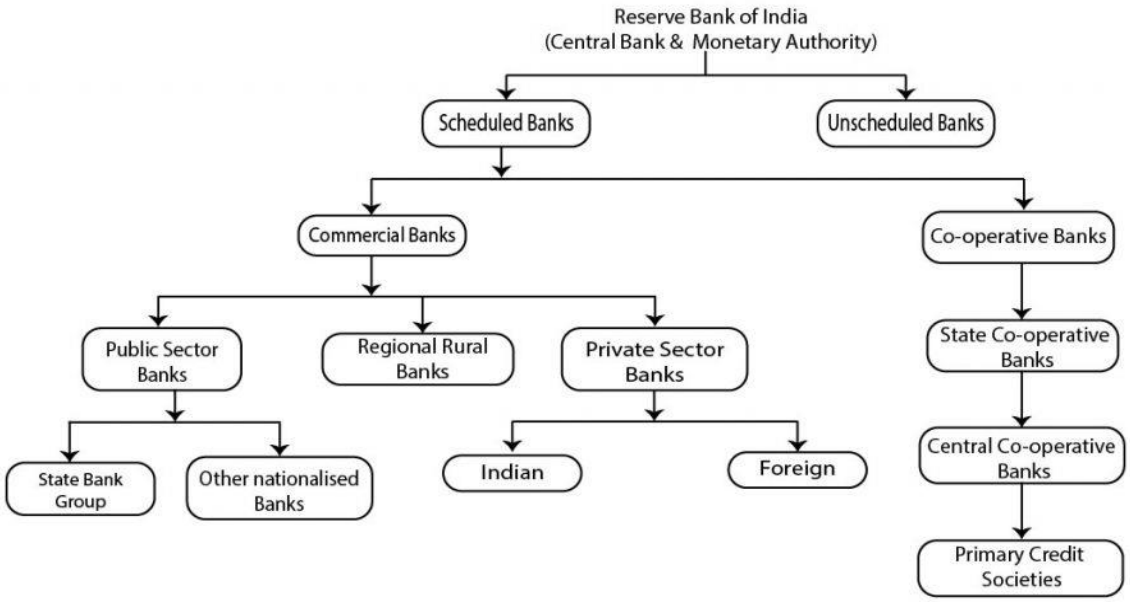
Meaning of Bank:-

A bank is a financial institution which accepts the deposits from the public (Small savers) and lends the money (Public deposits) to the required individuals and institutions.

Definition of Bank:

According to the Indian Banking Companies Act, 1949, "Banking means the acceptance for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

Classification of Banks:-


Reserve Bank of India
(Central Bank & Monetary Authority)
Scheduled Banks
Unscheduled Banks
Commercial Banks
Co-operative Banks
Public Sector Banks
Regional Rural Banks
Private Sector Banks
State Co-operative Banks
State Bank Group
Other nationalised Banks
Indian
Foreign
Central Co-operative Banks
Primary Credit Societies

A) Scheduled Banks:- Reserve bank of India is the highest monetary authority in the country. It makes rules and regulations for the scheduled commercial banks in India. Scheduled Banks in India are the banks which are listed in the second schedule of the Reserve Bank of India Act 1934. The scheduled bank enjoys several privileges as compared to non-scheduled banks. Scheduled banks are entitled to receive refinance facilities from the Reserve Bank of India. They are also entitled for currency chest facilities. They are entitled to become members of the clearing house. Besides commercial banks, cooperative banks may also become scheduled banks if they fulfill the criteria stipulated by RBI.

Definition :

"Banks which have been included in the second scheduled of the RBI Act, 1934". The banks included in this category should fulfill two conditions;

a) The paid up capital and collected fund of the bank should not be less than Rs 5lac.
b) Any activity of the bank will not adversely effect the interests of the depositors.

Examples:- State Bank of India, Nationalized Banks, Regional Rural Banks etc,.

Commercial Banks:- A commercial bank is also called as Business Bank, is a type of financial institution and intermediary, that lends money and provides transactional, saving and money market accounts and accepts time deposits.

According to the Indian Banking Companies Act, 1949, "Banking means the acceptance for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

Functions of Commercial Banks:

The functions of commercial banks can be broadly classified into Primary Functions (Basic), Secondary Functions (Agency) and General Utility Functions. Apart from the above banking functions, commercial banks also perform various non-banking functions.

1) Primary Functions:

The primary functions includes the following –

a) Accepting deposits from the public: Accepting various types of deposits from the public is an important function of the commercial banks. Those who have cash balances want to keep them in a safe place so they deposit the same with a bank. Commercial banks not only protect the cash of the customers but also provide a convenient method of transferring funds through the use of cheques. When the bank accepts deposits from people it is obliged to repay the same either in part or in full in legal tender money. The bank accepts deposits through four types of accounts from the public. They are –

a) Fixed Deposit Accounts
b) Saving Bank Accounts
c) Current Account Deposits and
d) Recurring Deposit Accounts

b) **Advancing of Loans:-** The commercial banks provide loans and advances of various forms. These are sanctioned to the approached customers on certain conditions and provisions.

a) **Overdraft:-** This is one of cash credit facility offered to current account holders. It is an arrangement with the bankers thereby the customer is allowed to draw money over and above the balance in his/her account. It is a short term temporary fund facility with interest charge over the amount overdrawn.

b) **Cash Credit:-** Cash credit is a form of working capital credit given to the business firms. Under this arrangement, the customer opens an account and the sanctioned amount is cedited with that account it is made against security of goods, personal security etc. the advantage of this mode is that bank charges interest only on the amount utilized and not on total amount sanctioned or credited to the account.

c) **Discounting bills:-** It is one of the primary operating of a bank where the bank purchases inland and foreign bills before these are due for payment by the drawer debtors, at a discounted values i.e., values a little lower than the face values.

d) **Loans and advances:-** It includes both demand and term loans, direct loans and advances given toa ll types of customers mainly to businessmen and investors against personal security or goods of movable or immovable in nature. The loan amount is paid in cash or by credit to customer account which the customer can draw at anytime.

c) **Credit Creation**:- Credit creation is also one of primary function. It appears when a bank sanctions a loan to a customer, it does not give cash to him, but, a deposit account is opened in his name and the amount is credit to his account. He can withdraw the money whenever he needs. Thus, whenever the bank sanctions a loan it creates a deposit.

2) **Secondary Functions:** Along with the primary functions, each commercial bank has to perform several secondary functions too. It includes many agency functions or general utility functions. These are listed below:-

a) **Agency Functions:-** These are the functions served by a commercial bank of behalf of its customers for a consideration. The various agency services are listed below:-

- To collect and clear cheque, dividends and interest warrant.
- To make payment of rent, insurance premium etc.
- To deal in foreign exchange transactions.
- To purchase and sell securities.
- To accept tax proceeds and tax returns.

b) **General/Public Utility function:-** These are the functions met by the commercial bank which are generally utilized by bank customers or general public for some amount of fee. These are listed below:

- To provide safety locker facility to customers.
- To provide money transfer facility.
- To issue traveler’s cheque.
- To accept various bills for payment e.g., phone bills, gas bills, water bills etc.

- To provide various cards such as credit cards, debit cards, smart cards etc.

Importance of Commercial Banks:

1. It encourages savings habit amongst people and thereby makes funds available for productive use.
2. It acts as an intermediary between people having surplus money and those requiring money for various business activities.
3. It facilitates business transactions through receipts and payments by cheques instead of currency.
4. It provides loans and advances to business for short term and long-term purposes.
5. It also facilitates import export transactions.
6. It helps in national development by providing credit to farmers, small-scale industries and self-employed people as well as to large business houses which lead to balanced economic development in the country.
7. It helps in raising the standard of living of people in general by providing loans for purchase of consumer durable goods, houses, automobiles etc.

Role of Commercial Banks:

1) **Banks promote Capital Formation:** Commercial banks accept deposits from individuals and businesses, these deposits are then made available to the businesses which make use of them for productive purposes in the country.
2) **Investment in New Enterprises: -** Businessmen normally hesitate to invest their money in risky enterprises. The commercial banks generally provide short and medium term loans to entrepreneurs to incest in new enterprises and adopt new methods of production.
3) **Promotion of Trade and Industry: -** With the growth of Commercial banking, there is vast expansion in trade and industry. The use of bank draft, cheque, bill of exchange, credit cards and letters of credit etc has revolutionized both national and international trade.
4) **Development of Agriculture: -** The commercial banks particularly in developing countries are now providing credit for development of agriculture and small scale industries in rural areas. The provision of credit to agriculture sector has greatly helped in raising agriculture productivity and income of the farmers.
5) **Balanced Development of different regions: -** The commercial banks play an important role in achieving balanced development in different regions of the country. They help in transferring surplus capital from developed regions to the less developed regions. This in turn increases investment trade and production in the economy.
6) **Influencing Economic Activity: -** The banks can also influence the economic activity of the country through its influence on availability of credit and the rate of interest. If the commercial banks are able to increase the amount of money in circulation through credit creation or by lowering the rate of interest.

7) **Implementation of Monetary Policy: -** The central bank of the country controls and regulates volume of credit through the active cooperation of the banking system in the country. It helps in bringing price stability and promotes economic growth within the shortest possible period of time.
8) **Monetization of the economy: -** The commercial banks by opening branches in the rural and backward areas are reducing the exchange of goods through barter. The use of money has greatly increased the volume of production of goods. The non-monetized sector is now being converted into monetized sector with the help of commercial banks.
9) **Export promotion cells: -** In order to increase the exports of the country, the commercial banks have established export promotion cells. They provide information about general trade and economic conditions both inside and outside the country to its customers. The banks are therefore, making positive contribution in the process of economic development.

Types of Scheduled Banks:

a) **Public Sector banks:-** The term 'Public sector banks' by itself connotes a situation where the major/full stakes in the banks are held by the government. 100% ownership of these banks were held by the government of India. By default the minimum 51% shares would be kept by the government of India, and the management control of these nationalized banks is only with Central Government. Example: State Bank of India, IDBI Bank and Regional Rural Banks.

b) **Regional Rural Banks:-** Since the middle of 1970's the Regional Rural Banks came into existence in India. These banks were set up with the specific objective of providing credit and facilities of deposits especially to small and marginal farmers, agricultural labour and artisans and small enterprises. The rural development in respect of agriculture, trade, commerce and industry is the prime responsibility of Regional Rural Banks of India.

c) **Private Sector banks:-** The major stake holders in the private sector banks are individuals and corporate. Some of the leading banks which were given licenses are: Axis Bank, ICICI Bank, HDFC Bank, Kotak Mahindra Bank etc. Private sector banks have been rapidly increasing their presence in the recent times and offering a variety of newer services to the customers and posing a stiff competition to the group of public sector banks.

Co-operative Banks:- Cooperative banks play an important role in the Indian Financial System, especially at the village level. The growth of co-operative movement commenced with the passing of the act of 1904. A cooperative bank is a cooperative society registered or deemed to have been registered under any state or central Act. If a cooperative bank is operating in more than one state, the central cooperative societies act is applicable. In other cases the state laws are applicable.

1) **Urban Co-operative Banks:-** The urban areas are served by the urban cooperative banks. These banks are registered under cooperative societies act of the respective state governments. The RBI is the regulatory and supervisory authority of these banks for their

banking related operations. The RBI extends refinance to these banks at bank rate against their advances to tiny and cottage industrial units.

2) **Rural Co-operative Banks:-** The rural areas are largely served by the rural co-operative credit institutions. There is a three tire structure consisting of:
   a) The state Co-operative Banks at the apex level at the state level.
   b) The District Co-operative banks at the intermediate level existing at district level.
   c) The primary Co-operative credit societies at the grassroots level.

B) Non-Scheduled Banks:- These are those banks which are not included in the second schedule of the Reserve bank of India. Usually those banks do not conform to the norms of the Reserve Bank of India within the meaning of the RBI Act or according to the judgement of the Reserve Bank, are not capable of serving and protecting the interest of depositors are classified as non-scheduled banks. These banks which are not in the second schedule of RBI Act 1934. All local area banks are called the non-scheduled banks.

Cash Reserve Ratio (CRR) :- It is certain minimum amount of cash reserve maintained by all commercial or scheduled banks in India with Reserve Bank of India (RBI). RBI uses CRR as tool to increase or decrease the reserve requirement depending on whether RBI wants to increase or decrease in the money supply.

Sources and Application of Funds of Commercial Bank

1) Sources of Funds:- There are different sources available to a bank to borrow fund on certain conditions basis. The banks normally use different securities to rise short term and long term funds. Despite of this, the banking regulation act specified some of the sources from which a bank can raise the funds.

a) **Share capital:-** It is the owners fund employed for the life time of the bank. In nationalized banks the share capital is contributed by central government. But in Private Banks, the share capital is introduced by public and private people.

b) **Reserves and Surplus:-** These are the retained earnings maintained in the bank out of surplus profit. Statutory reserves (25% of current year profit), capital reserves, share premium, revenue and other reserves and balance of profit are the items which come under this category.

c) **Deposits:-** These are the received funds from the general public under a particular scheme of account for a definite tenure of time. Deposits are classified into demand deposits, savings bank deposits and term deposits.

d) **Borrowings:-** The bank can borrow funds from different sources on certain conditional basis. The two sources of borrowings are borrowings in India (RBI, other banks and institutions) and borrowings outside India.

2) **Application of Funds: -** The asset structure represents different forms of assets held by a commercial bank on a particular period of time. The assets of a bank are shown under the heading of application of funds.

a) **Cash and Cash balance with RBI: -** It is a form of liquid asset kept in the form of cash in hand and balance kept at Reserve Bank of India. These are used to discharge the obligations arrived immediately. Cash in hand includes foreign currency notes also. And balance with RBI represents balance in current and other accounts.

b) **Cash balance with ither banks, money at call and short notices: -** It is also a for, of liquid asset kept with other banks in current and other deposit accounts. Money at call and short notices are the deposits repayable within 15 days or less than 15 days notice lent in the inter-bank call money market.

c) **Investments: -** these include central and state government securities and government treasury bills. These securities should be shown at the book value in the balance sheet.

d) **Advances: -** These are the loans and advances given by the bank to the different customers in different schemes. The advances are classified into three categories. They are

- Bills purchased and discounted
- Cash credits, overdrafts and loans payable on demand
- Term loans

e) **Fixed Assets:-** These are the assets of the bank which are employed and the return on which earned for a long time. Fixed assets are classified into premises and other fixed assets.

f) **Other assets:-** These are also meant as current assets and transacted for short period of time.

Investment policy of Commercial Banks:

1) **Liquidity**:- Liquidity also means the ability of the bank to convert its non-cash assets into cash easily and without loss. The bank cannot have all its assets in the form of cash because it is an idle asset which does not fetch any return to the bank. So some of the assets of the bank, money at call and short notice, bills discounted, etc. could be made liquid easily and without loss.

2) **Profitability:-** A commercial bank by definition, is a profit hunting institution, Bank has to earn profit to earn income to pay salaries to the staff, interest to the depositors, dividend to the shareholders and to meet the day-to-day expenditure. Since cash is the least profitable asset to the bank, there is no point in keeping all the assets in the form of cash on hand. The bank has to earn income.

3) **Safety or Security:** Apart from liquidity and profitability, the bank should look to the principle of safety of its funds also for its smooth working. While advancing loans, it is necessary that the bank should consider the character, capacity and collateral of the borrower.

4) **Diversity:-** The bank should invest its funds in such a way as to secure for itself an adequate and permanent return. And while investing its funds, the bank should not keep all its eggs in the same basket. Diversification of investment is necessary to avoid the dangerous consequences of investing in one or two channels. If the bank invest its in different types of

securities or makes loans and advances to different objectives and enterprises, it shall ensure for itself a regular flow of income.

5) **Salability of securities:-** Further, the bank should invest its funds in such types of securities as can be easily marketed at a time of emergency. The bank cannot afford to invest its funds in very long term securities or those securities which are unsalable. It is necessary for the bank to invest its funds in government or in first class securities or in debentures of reputed corporations.

6) **Stability in the value of investments:-** The bank should invest its funds in those stocks and securities the prices of which are more or less stable. The bank cannot afford to invest its funds in securities, the prices of which are subject to frequent variations.

7) **Principles of Tax-Exemption of Investments:-** Finally, the investment policy of a bank should be based on the principle of tax exemption of investments. The bank should invest in those government securities which are exempted from income and other taxes. This will help the bank to increase its profits.

Chapter 03:- Regulatory Institutions

Introduction to RBI:

The Reserve Bank of India (RBI) is India's central bank, also known as the banker's bank. The RBI controls monetary and other banking policies of the Indian government. The Reserve Bank of India (RBI) was established on April 1, 1935, in accordance with the Reserve Bank of India Act, 1934. The Reserve Bank is permanently situated in Mumbai since 1937.

History of RBI

Early 1935, the functions of central bank were maintained by Government and Imperial Bank of India. Government of India was maintaining the function of note issue, management of foreign exchange reserve etc. and imperial bank of India was acting as bankers to bank and Bankers to government.

In 1926 "The commission on Indian currency and finance" was appointed, which was headed by Edward Hilton young. This committee is also called as Hilton young commission". Each member of this committee have studied the book, "The problem of the Rupee-its origin and its solution, which was written by Dr. B.R Ambedkar.

Preamble:

The preamble of Reserve Bank of India describes the basic functions of the reserve bank as:

"To regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantages".

Objectives of RBI:

- To regulate the issue of Banknotes.
- To secure monetary stability in the country.
- To meet the economic challenges by modernizing the monetary policy framework.
- To manage the monetary and credit system of India.
- To stabilize Internal and External value of rupee.
- To develop organized money market in India.
- To properly arrange for agricultural and industrial finance.
- To centralize cash reserves of commercial banks.
- To play a crucial role in growth of Indian economy.
- To ensure bank penetration and safety of depositor's fund.

Functions of RBI:

1. Issue of Notes :- The Reserve Bank has the monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations except one rupee note (which is issued by the Ministry of Finance). The Reserve Bank has adopted the **Minimum Reserve System** for issuing/printing the currency notes.

The note issue process of RBI is done through two departments, namely issue department and Banking Department.

- Issue Department:- Issue department issues currency notes. Currency notes are issued by backing equal value of assets. Here assets refers to gold, bullion, foreign securities, Government Securities etc.
- Banking Department:- Banking department takes care of banking operations. It releases the currency for circulation and withdraw currency from circulation. The process of issuing new currency for circulation is called expansion of currency. The process of with drawing currency from circulation is called contraction of currency.

Principles of Note issue:-

- Currency principle:- Under this principle RBI has to maintain 100% gold reserve to issue currency notes. Here each and every currency notes are to be backed by same value of gold reserve.
- Banking Principle:- Under banking principle RBI has no need to maintain 100% gold reserve to issue currency notes. A certain percentage of currency notes can be backed by gold and remaining portion of currency notes can be backed by securities.

Methods of Note issue:-

- Fixed fiduciary method:- Under this method RBI fixes certain limit, that limit is know as fiduciary limit. Up to this limit RBI can issue notes by reserving securities and beyond the limit of note issue must be backed by gold. This method of note issue is called Fixed fiduciary method.
- Proportionate Reserve system:- Under this method certain percentage of note issue can be backed by gold and remaining percentage of the note issue can be backed by securities. Here currency issue is being proportionated usually 25% to 40% of note issue will be backed by gold and remaining percentage will be backed by securities.
- Minimum reserve system:- Under this system a minimum amount of reserve can be maintained against all note issue. Here there is no maximum limit to issue currency notes, any quantity of notes can be issued and irrespective of note issue only a minimum percentage of currency will be backed by reserves usually 20% to 30% note issue will be backed by reserve.

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

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

4. Controller of the Credit:- The RBI undertakes the responsibility of controlling credit created by the commercial banks. RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country.

5. Custodian of Foreign Reserves:- For the purpose of keeping the foreign exchange rates stable, the Reserve Bank buys and sells the foreign currencies and also protects the country's foreign exchange funds. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa.

6. RBI acts as advisor to government: RBI has superior knowledge in the field of finance and other area. It advises government in the matters of finance, banking, loans, planning and economic developmental activities.

7. Clearing House:- RBI acts as clearing house for settlement of banking transactions which enables banks to settle their interbank claims easily. RBI operate clearing house and interbank cheque clearing settlement will be done twice in a day.

8. Lender of last resort:- RBI is the lender of last resort for all commercial banks when commercial banks are in need of money they normally go to other commercial bank for short term assistance.

9. Promotional functions:- The Reserve Bank was asked to promote banking habit, extend banking facilities to rural and semi- urban areas, and establish and promote new specialized financing agencies. Accordingly, the Reserve Bank has helped in the setting up of the Industrial Finance Corporation of India and the State Financial Corporations; it set up the Deposit Insurance Corporation in 1962, the Unit Trust of India in 1964, the Industrial Development Bank of India also in 1964, the Agricultural Refinance Corporation of Indian in 1963 and the Industrial Reconstruction Corporation of India in 1972.

10. Other Functions:- The Reserve Bank performs a number of other developmental works. These works include the function of clearing house arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities (gilt edge, treasury bills etc) and trade bills, giving loans to the Government buying and selling of valuable commodities etc.

Monetary Policy:-

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.

Definition:

"Monetary policy is the framework that deals with money supply, creating employment and controlling inflation in an economy".

Objectives of Monetary Policy:-

- Ensure price stability of commodities in the country.
- Ensure balanced credit expansion.
- Ensure growth of long term investments in the economy.
- Ensure proper balance of exports and imports.
- Encourage food procurement operations.
- Ensure proper distribution of credit to all sectors of the economy.

Credit Control Methods of RBI

Credit control metho0ds of RBI are classified into two i.e Quantitative Method and Qualitative Method.

I. Quantitative Methods:- Quantitative credit control is a method where in this method RBI control the total quantity of credit which bank lends to borrower.

The various quantitative techniques are discussed as follows.

1. **Bank Rate Policy:-** Bank rate is standard rate at which RBI buy or discount bill of exchange, commercial paper is known as bank rate or discount rate. RBI provides money to commercial banks by discounting bills which is in the hands of commercial bank. At the time of inflation RBI increases the bank rate, higher the bank rate reduces the amount of the commercial banks which reduces the bank capacity to lend.
2. **Open Market Operations:-** Open market operation is one of the methods to control money supply. If RBI wants to decrease the money supply it compels commercial bank and other institution to purchase treasury bills and other financial instrument which is there with RBI. So, money in the hands of the banks flow to RBI.

3. **Variable Reserve Ratio:-** RBI controls credit through variable reserve ratio. The variable reserve ratios are cash reserve ratio and statutory liquidity ratio etc. CRR and SLR are short term tools to control money supply.

- **Cash Reserve Ratio:-** All commercial banks are required to maintain certain amount of its deposit with RBI. This portion of amount is called as cash reserve ratio. CRR affect on banks lending policy. High rate of CRR enables less lending capacity and vice versa. CRR and SLR are very much useful to control inflation and deflation.
- **Statutory Liquidity Ratio:**- Commercial banks in India are required to maintain a certain portion of its demand deposit and time deposit in the forms of government

- **Statutory Liquidity Ratio:-** Commercial banks in India are required to maintain a certain portion of its demand deposit and time deposit in the form of government securities and other specified securities. It means commercial banks should invest certain portion of their demand and time deposit money on Government and other securities which affects the banks liquidity.

4. **Lending Rate Policy:-** Lending rate is the standard interest rate fixed by RBI on commercial bank to lend loan. At the time of inflation normally RBI increases lending rate which reduces the money supply due to hesitation of the people to take loan and at the time of deflation RBI decreases the interest rate. Lower the interest rate attracts the more borrower which results in tremendous increase in money supply. Hence lending rate helps to control inflation and deflation.
5. **Repo Rate:-** Repo rate is a rate at which RBI lends amount to commercial bank. Higher the repo rate does not attract commercial banks to borrow money from RBI which reduces the borrowing capacity of commercial banks to lend amount. On the other side lower the Repo rate attracts commercial bank and money flow from RBI to commercial bank which enlightens on lending capacity of commercial bank.
6. **Reverse Repo Rate:-** Reverse repo rate is a rate at which RBI borrow money from commercial bank. When RBI feels to reduce money supply in the economy it increases the reverse repo rate. Then all commercial banks would like to lend more amounts to RBI. The banks might have earn more income if they would have invest their money in RBI than lending to others due to high reverse repo rate. Hence money flow from commercial banks to RBI and liquidity position with RBI reduces.

Qualitative Credit Control:- Under this method RBI channelizes the credit of commercial banks to prioritized sector. This method is also called as 'selective methods of credit control' where RBI regulates the total credit of commercial banks for particular use. This method is known as quantitative credit control.

The following are the various quantitative credit control methods:-

1. **Fixation of Margin:-** At the time of lending loan borrower needs to pledge certain assets or properties for certain value. RBI directs the different margin for different sectors higher margin will be the possibility of less loan because borrower may not afford more value of asset to borrow amount and lesser the margin attracts more borrower and more loans.

2. **Regulation of Consumer Credit:-** Regulation of consumer credit is one of the weapons to control inflation or deflation. RBI regulates consumer credit by imposing various policies. At the time of inflation, it feels to restrict money supply and it impose tight policies on consumer credit. At the time of deflation, it imposes liberalized credit policy on consumer credit which enables consumers to take more credit and increases money supply which ultimately brings down the deflation situation.

3. **Direct Action:-** Under the Banking Regulation Act, RBI has power to take strict action on any commercial bank which is against RBI's policy. Each and every bank has to obey the rules imposed by RBI otherwise the bank will be punished severely. All the banks have to consider RBI's guidelines even at the time of lending loan.

4. **Variable Portfolio ceilings**:- Under this method, RBI fixes maximum loan limit which can be lent by commercial banks to various sectors and commercial banks should not exceed the ceiling limit. Here RBI controls the credit of commercial banks and channelizes it according to the requirement.

5. **Publicity:-** RBI prints periodical bulletins and articles through which it highlights the economic conditions and advises the banks regarding their lending policy and also creates awareness among the public towards economic conditions.

6. **Moral suasion:-** In addition to above methods, moral suasion also helps to control the credit of commercial banks. Moral suasion implies persuasion and request made by RBI to follow certain policies. In this context, there is no legal compulsion to follow the request of RBI.

Securities and Exchange Board of India (SEBI)

It was established by the Government of India on 12th April, 1988 as a regulator of capital market in the country in order to promote orderly and healthy growth of securities market and for investor protection. The SEBI was given a statutory status by passing Securities and Exchange Board of India Act in 1992.

The SEBI has the powers concerning various aspects of capital market, such as regulating stock market, mutual funds market, promoting investors' education, establishing self-regulating organizations and steps to prohibit unfair trade practices and insider trading in the security market.

Objectives and Functions of SEBI

The overall objectives are as follows:

a) **Development of securities market:** For a long period, the securities market remained under-developed due to variety of malpractices on the part of companies, brokers, merchant bankers and others involved in the securities market. SEBI was set up mainly to develop the capital market in general and securities market in particular.

b) **Protection of Interest of Investors:** SEBI aims at protecting the rights and interests of investors through accurate and authentic information. SEBI prosecutes the defaulting companies in the matters of non-payment of dividend or non-issue of certificate of shares after allotment etc.

c) **Regulation of Capital Market:** SEBI regulates both the primary and secondary capital markets. Every issue of shares to the public by the companies is subject to clearance from SEBI. It also issues guidelines from time to time to regulate stock exchanges regarding time, settlement, speculation etc.

Functions of SEBI

The principal functions of SEBI are as follows:

a) Regulating the business in stock exchanges and any other securities market.

b) Registering and regulating the working of capital market intermediaries (brokers, merchant bankers and so on).

c) Registering and regulating the working of mutual funds.

d) Promoting and regulating self-regulatory organizations.

e) Prohibiting fraudulent and unfair trade practices in securities market.

f) Promoting investors' education and training of intermediaries of securities market.

g) Prohibiting insider trading in securities.

h) Regulating substantial acquisition of shares and take-over of companies,

i) Conducting enquiries and audits of stock exchanges,

j) Levying fees and other charges for carrying out its functions,

k) Conducting research for the above purposes.
l) Performing such other functions as may be prescribed by the Act or by the Government.

Powers of SEBI

- Calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by the board.
- Power to levy fees or other charges for carrying out the objectives.
- Formation of rules and regulation for controlling the stock exchanges in India.
- Power to amend the rules and regulations of stock exchanges in India.
- Power to stop all fraud and malpractices in stock exchanges.
- Power to regulate stock exchanges of India.
- Power to investigate any functions of stock exchanges.
- Power to issue directions to stock exchanges, brokers, underwriters and companies.
- Power to protect investors by regulating the stock market.
- Power to compel listing of securities by Public companies.

Book Building

Book Building is a process in that process company determines the quantum of shares to be issued and the price at the shares to be issued are determined.

SEBI Guidelines on Book Building:-

1) The option of 100% book building shall be available only to issuing companies which process to make an issue of shares of Rs. 5 crores and above.
2) The issuing company shall appoint category I Merchant Banker or Bankers as the book runner or runners, and their names shall be mentioned in the draft prospectus submitted to SEBI.
3) The lead merchant banker shall act as the lead book runner.
4) The syndicate members, who are appointed by the lead book runner, shall be intermediaries who are registered with SEBI and who are permitted to carry on activities as underwriters.
5) The draft prospectus or red-herring prospectus shall be filled with SEBI with SEBI by the lead merchant banker who acts as the lead book-runner.
6) The issuing company, after receiving final observations, if any, on the offer document from SEBI, shall make an advertisement in newspaper regarding book-building.
7) Once the final issue price is determined, all those bidders whose bids have been found to be acceptable shall be entitled to allotment of shares.
8) On determination of the entitlement, the information regarding the entitlement shall be intimated to the investors immediately.

9) The offer shall remain open for subscription by public for period of at least three working days.
10) Arrangements shall be made by the issuing company for collection of the applications by having the required mandatory collecting centers depending upon the size of the issue.
11) Allotment shall be made not later than 15 days from the closure of the issue, failing which interest at 15% shall be paid to the investors.
12) The SEBI shall have the right to carry out inspection of the records, books and documents relating to the book building process.

Chapter 04:- Non-Banking Financial Institutions

Introduction:

Non Banking Financial Institutions or companies, which collect funds from people in different forms and make the same available as loans to needy people or institutions and are registered under company Act are called as Non Banking Financial Institutions. The RBI Act 1997 defines NBFI as an institution or company whose principle business is to accept deposit under any scheme or arrangement or in any manner, and to lend in any manner. Due to this Definition many loan and investment companies have been reported as NBFCs.

Meaning/Definition of NBFCs:

According to the RBI act of 1997, NBFI means-

a) A financial institution, which is a company.
b) Its main business is to collect money in various forms from people and lending the same to needy people or institutions.
c) A Non- Bank Institution declared so by RBI with the permission of Government of India.

NBFI are all those institutions, which are engaged in the business of hire purchase finance , housing finance, investment, loans, leasing, mutual funds etc.

Classification of Non-Banking Financial Institutions:

a) Unorganized Non-Banking Financial Institutions
   i) Funds
   ii) Chit-Funds
   iii) Finance Company
   iv) Investment Institution
b) Organized Non-Banking Financial Institutions
   i) Development Banks
   ii) Investment Banks
   iii) Specialized Investment Banks
   iv) Post Office
   v) Provident fund, Pension Fund
   vi) Mutual Funds.

a) Unorganized Non-Banking Financial Institutions

These are unorganized, work independently, and without any co-ordination. These are as follows:

1) **Fund:-** Such Funds are more active in South India. They register under company act, collect deposits from members and lend money for buying or against house property, gold jewellery. They also lend for marriages and for paying off old debts.

2) **Chit Funds:-** Some people come together and form groups. The group members contribute to the fund, out of which loan is issued to a person whose name comes on the chit which gets selected. Only group members are entitled to get loans. Such chit funds were prominent in Tamilnadu and Kerala in the beginning but have now spread to other states as well.

3) **Finance Company:-** These are the companies which have their own capital of Rs.1 lakh and also raise funds through sale of shares. They collect deposits by offering attractive rate of interest and provide loans of traders, businessmen, and small entrepreneurs. Those who cannot obtain loans from commercial banks, turn to such finance companies for high interest loans. These companies are not registered with RBI.

4) **Investment Institutions:-** these institutions collect money from the people and invest in debt market or in debentures of companies. First these investment institutions came into existence in 1933 by the name of industrial investment trust. There number increased in the later period and now their number is at around 600. These institutions are private limited companies. These have been promoted by leading industrialists like Birla, Dalmiya, J.K Group etc.

b) Organized Non-Banking Financial Institutions

1) **Development Banks:-** These banks have been dealt with in the beginning of this unit.

2) **Investment Banks:-** Investment banks are those financial entities which collect money from public in one form or another and invest as per their policy. For example, Unit trust of India(UTI) collects money y selling its units and lends the same money to production units, invests in debt market. Life insurance Corporation (LIC) collect money as insurance premium and invest the same in debt market.

3) **Specialized Investment Banks:-** Some financial institutions work as specialized investment banks. They concentrate only in one area, for example, house construction, tourism development etc.

4) **Post Office:-** Post and Telegraph department of Govt. of India has a countrywide network. Post offices accept deposits since 1982 and they amounted to Rs 311782 crores until 2003. This money is invested in accordance with the rules of post and Telegraph department.

5) **Provident Fund:-** A certain percent amount is collected from the monthly salary of an employee for the provident fund. Employees of Govt. and semi-govt. enterprises, also of private enterprises can avail the facility of provident fund. Provident fund had a total collection of Rs 25,438 crores untill 1995-96. This money is made available to the govt. for investment in public sector.

6) **Mutual Funds**:- it plays the role of an intermediator between people and business units. Those people who lack the knowledge of investing, hand over their money to mutual funds and these in turn, invest fund in a manner to secure maximum return to the people.

Features of Non-Banking Financial Institutions

1) **Small Size:-** NBFIs are small entities in terms of their size and scope. Some NBFIs are larger in size like provident fund, Pension Fund etc., but mostly these are small size institutions. Their structure is easy and simple and management cost is low.

2) **Less capital intensive:-** These entities have very low amount of owned capital. The attractive returns offered help them to collect larger sum of money from the people. If they do not offer attractive returns to the people, their existence will be in danger, as they will find it difficult to collect deposits.

3) **Easy availability of loans:-** Borrowers turned down by the commercial banks and development banks, go to these NBFIs. Loans from NBFIs are easily available as very few documentation is required. Handicraft and small industries, small businessmen, sundry traders, often turn to NBFIs for loans.

4) **Unsafe loans**:- the loans offered by NBFIs involve more risk as these are offered without or with inadequate mortgage. The recovery of loans, therefore, becomes difficult.

5) **Rescheduling of Loans:-** Many a times, the loans offered for short and medium term are not recovered and, therefore, converted into long term loans. As a result, amount of loan, term and rate of interest increase.

6) **Lack of Co-ordination:-** The number of NBFIs has increased rapidly. Up to 1996, there were 39,450 NBFIs working in India. Most of the NBFIs were small size entities with very few large ones. These smaller size NBFIs do not have any co-ordination among them. They act independently and focus on short- term profit and therefore, do not survive in the long run.

7) **Annual report and balance sheet:-** Except few, most NBFIs ignore auditing of their accounts, publication of balance sheet and other relevant information. This is not good from the point of view of depositors.

8) **Independent Policy:-** NBFIs are required to follow the rules and orders of RBI. They are registered under company act, but capital limitation, profit provisioning maintaining reserves, auditing of accounts and publication of balance sheet etc., are not binding on them. As a result, many NBFIs emerge and conduct their business independently.

Industrial Finance Corporation of India

Government of India set up the Industrial Finance Corporation of India (IFCI) in July 1948 under a special Act. This is the first financial institution set up in India with the main object of making medium- and long-term credit to industrial needs.

The authorized share capital of the IFCI was Rs. 10 crore at the initial stage, According to the Industrial Finance Corporation (Amendment) Act, 1986, the authorized capital of the corporation has been raised from Rs. 100 crore to Rs. 250 crore (the authorized capital may be fixed by the government of India by notification from time to time).

The functions of the IFCI are as follows:-

The corporation grants loans and advances to industrial concerns.
(ii) Granting of loans both in rupees and foreign currencies.
(iii) The corporation underwrites the issue of stocks, bonds, shares etc.
(iv) The corporation can grant loans only to public limited companies and co-operatives but not to private limited companies or partnership firms.

Organisation and Management:

The Head Office of the IFCI is in New Delhi. It has also established its Regional offices in Bombay, Chennai, Kolkata, Chandigarh, Hyderabad, Kanpur and Guwahati. The branch office of IFCI is located in Bhopal, Pune, Jaipur, Cochin, Bhubaneswar, Patna, Ahmedabad and Bangalore.

The IFCI is managed by a Board of Directors, headed by a Chairman, who is appointed by the Government of India, in consultation with RBI. The chairman holds his position for a period of 3 years, subject to extension. Of the 12 directors, 4 are nominated by the IDBI, three of whom are experts in the fields of industry, labour and economics and the fourth is the General Manager of the IDBI. The remaining 8 directors are nominated.

Activities of the IFCI:

1. Soft Loan Assistance: This scheme provides soft loan assistance to existing industries in small and medium sector for developing technology through in-house research and development.

2. Entrepreneur Development: IFCI provides financial support to EDPs (Entrepreneur Development Programmes) conducted by several agencies all-over India. In co-operation with Entrepreneurship Development Institute of India.

3. Industrial Development in Backward Areas: IFCI also take measures to promote industrial development in backward areas through a scheme of concessional finance.

4. Subsidised Consultancy: The IFCI gives subsidised consultancy for,
(i) Small Entrepreneurs for Meeting the Cost of Project.
(ii) Promoting Ancillary Industries
(iii) To do the Market Research.
(iv) Reviving Sick Units.
(v) Implementing Modernisation.
(vi) Controlling Pollution in Factories.

5. Management Development: To improve the professional management the IFCI sponsored the Management Development Institute in 1973. It established the Development Banking Centre to develop managerial, manpower in industrial concern, commercial and development banks.

Industrial Development Bank of India

IDBI stands for Industrial Development Bank of India. It is an Indian government-owned financial service company, headquartered in Mumbai. It was formerly known Industrial Development Bank of India. It was established in 1964 to provide credit and other financial facilities for the development of Indian industry. It was given complete autonomy in February 1976.

Functions of the IDBI

1. Planning, promoting and developing industries with a view to fill the gaps in the industrial structure by conceiving, preparing and floating new projects.
2. Providing technical and administrative assistance for promotion, management and expansion of industry.
3. Providing refinancing facilities to the IFCI, SFCs and other financial institutions approved by the government.
4. Coordinating the activities of financial institutions for the promotion and development of industries.
5. Purchasing or underwriting shares and debentures of industrial concerns.
6. Guaranteeing deferred payments due from industrial concerns and for loans raised by them.
7. Undertaking market and investment research, surveys and techno-economic studies helpful to the development of industries.

In short, the IDBI is the leader, coordinator and innovator in the field of industrial financing in our country. Its major activity is confined to financing, developmental, co-ordination and promotional functions.

Export and Import Bank (EXIM Bank)

EXIM Bank is the premier export finance institution of the country, established in 1982 under the export-import bank of India Act, 1981.The head-quarter of the bank is located in Mumbai, India, Since EXIM bank is a banking financial service corporate, it is established to finance and support export and import activities.

Objectives of EXIM bank:

1. To ensure and integrated and co-ordinated approach in solving the allied problems encountered by exporters in India.
2. To pay specific attention to the exports of capital goods.
3. Encouraging Exports.
4. To facilitate and encourage joint ventures and export of technical services and international and merchant banking.
5. To extend buyers' credit and lines of credit.
6. To tap domestic and foreign markets for resources for undertaking development and financial activities in the export sector.

Functions of Exim Bank

(a) Planning, promoting and developing exports and imports.

(b) Providing technical, administrative and managerial assistance for promotion, management and expansion of exports.

(c) Undertaking market and investment surveys and techno-economic studies related to development of exports of goods and services.

State Financial Corporations (SFCs)

A central industrial Finance Corporation was set up under the industrial finance corporation act, 1948 in order to provide medium- and long-term credit to industrial undertakings which fall outside the normal activities of commercial banks. The state Governments expressed their desire that similar corporations be set up in the states to supplement the work of the industrial finance corporation.

Objectives of SFCs:-

1) To establish uniformity in regional industries.
2) To provide incentive to new industries.
3) To bring efficiency in regional industrial units.

4) To provide finance to small-scale, medium sized and cottage industries in the state.
5) To develop regional financial resources.

Functions of SFCs:-

1) To provide loans for a period not exceeding 20 years to the industrial units.
2) To underwrite the issue of shares, debentures and bonds for a period not exceeding 20years of industrial units.
3) To give guarantee to loans taken by industrial units for a period not exceeding 20 years.
4) To make payment of capital goods purchased in India by these industrial Units.
5) To Subscribe to the share capital of the industrial units, in case they wish to raise additional capital.
6) To do all such acts may be incidental of its duties under this act.

Mutual Funds:-

A mutual fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciations realized are shared by its unit's holders in proportion to the number of units owned by them.

Types of Mutual Funds:-

1. **Based on Structure**

Mutual funds are also categorised based on different attributes (like risk profile, asset class, etc.). The structural classification – open-ended funds, close-ended funds, and interval funds – is quite broad, and the differentiation primarily depends on the flexibility to purchase and sell the individual mutual fund units.

a. Open-Ended Funds: Open-ended funds do not have any particular constraint such as a specific period or the number of units which can be traded. These funds allow investors to trade funds at their convenience and exit when required at the prevailing NAV (Net Asset Value). This is the sole reason why the unit capital continually changes with new entries and exits. An open-ended fund can also decide to stop taking in new investors if they do not want to (or cannot manage significant funds).

b. Closed-Ended Funds: In closed-ended funds, the unit capital to invest is pre-defined. Meaning the fund company cannot sell more than the pre-agreed number of units. Some funds also come with a New Fund Offer (NFO) period; wherein there is a deadline to buy units. NFOs comes with a pre-defined maturity tenure with fund managers open to any fund size. Hence, SEBI has mandated that investors be given the option to either repurchase option or list the funds on stock exchanges to exit the schemes.

c. Interval Funds: Interval funds have traits of both open-ended and closed-ended funds. These funds are open for purchase or redemption only during specific intervals (decided by the fund house) and closed the rest of the time. Also, no transactions will be permitted for at least two years. These funds are suitable for investors looking to save a lump sum amount for a short-term financial goal, say, in 3-12 months.

2. Based on Investment Goals

a. Growth Funds: Growth funds usually allocate a considerable portion in shares and growth sectors, suitable for investors (mostly Millennials) who have a surplus of idle money to be distributed in riskier plans (albeit with possibly high returns) or are positive about the scheme.

b. Income Funds: Income funds belong to the family of debt mutual funds that distribute their money in a mix of bonds, certificate of deposits and securities among others. Helmed by skilled fund managers who keep the portfolio in tandem with the rate fluctuations without compromising on the portfolio's creditworthiness, income funds have historically earned investors better returns than deposits. They are best suited for risk-averse investors with a 2-3 years perspective.

c. Liquid Funds: Like income funds, liquid funds also belong to the debt fund category as they invest in debt instruments and money market with a tenure of up to 91 days. The maximum sum allowed to invest is Rs 10 lakh. A highlighting feature that differentiates liquid funds from other debt funds is the way the Net Asset Value is calculated. The NAV of liquid funds is calculated for 365 days (including Sundays) while for others, only business days are considered.

d. Tax-Saving Funds: ELSS or Equity Linked Saving Scheme, over the years, have climbed up the ranks among all categories of investors. Not only do they offer the benefit of wealth maximisation while allowing you to save on taxes, but they also come with the lowest lock-in period of only three years. Investing predominantly in equity (and related products), they are known to generate non-taxed returns in the range 14-16%. These funds are best-suited for salaried investors with a long-term investment horizon.

e. Aggressive Growth Funds: Slightly on the riskier side when choosing where to invest in, the Aggressive Growth Fund is designed to make steep monetary gains. Though susceptible to market volatility, one can decide on the fund as per the beta (the tool to gauge the fund's movement in comparison with the market). Example, if the market shows a beta of 1, an aggressive growth fund will reflect a higher beta, say, 1.10 or above.

Importance of Mutual Funds:

a. Professional Investment Management:

The money pooled in the mutual fund is managed by professionals who decide investment strategy on behalf of the unit holders. Because of the relatively large pool of investable funds, mutual funds have the resources to hire very qualified, full time investment managers. These professionals choose investments that best match the investment objective of the scheme as described in the scheme's prospectus.

b. Risk Reduction through Diversification:

The old axiom that 'it is not wise to put all eggs into one basket' was probably in the minds of those who formed the first mutual fund. The one important thing one should keep in mind regarding diversification is that one is interested in risk as well as returns.

c. Availability of Varied Portfolio Objectives:

There are more than 400 mutual fund schemes with wide variety of investment objectives and options available to investors in India.

d. Convenience:

Mutual funds provide investors with variety of products and increasingly broad array of customer services. The increasing breadth of mutual fund products and services offer investors a great deal of choice in picking up the scheme that is consistent with his risk-return-liquidity requirements.

e. Reduction in Cost of Investment:

Average cost of managing a rupee will be much lower for a mutual fund then for an investor managing a diversified portfolio all on his own. The low costs are due to standardization, and high economies of scale (arising on account of the collective investment character).

g. Regulatory Protection:

Mutual funds are subject to strict regulation and oversight by SEBI. As part of this regulation all mutual funds provide full and complete disclosures about the funds in a written offer document. This offer document describes, among other things scheme's investment objectives, its investment policies, its investment methods, and information about how to purchase and redeem units and information about risk the portfolio of the scheme is exposed to.

Payment Banks

A payment bank has been categorised as a scheduled bank, conceptualised by Reserve Bank of India formed committee headed by Dr Nachiket Mor. The main objective of payments bank is to broaden the reach of payment and financial services to small businesses, low-income households, migrant labourers in a very secured technology-enabled environment.

A payment bank is like any other bank, but operating on a smaller scale without involving any credit risk. In simple terms, it can carry out most banking operations but can't offer advance loans or credit cards. It can accept demand deposits, offer remittance services, mobile payments, transfer/purchases and other banking services like ATM, Net banking and third-party fund transfer.

Features of Payment Banks:

1) Payment banks can also accept demand deposits (only current account & savings accounts) with a ceiling limit of Rs 1 lakh per customer.
2) Payment banks must pay interest at the rate notified by the RBI.
3) Payment banks can issue debit cards but not credit cards.
4) Payment banks cannot engage in lending services i.e. they cannot provide loans, thus by phasing out the fear of NPA.
5) The deposit up to Rs1 lakh is insured by the DICGC (Deposit insurance and credit Guarantee corporation) same as in bank account.
6) Payment bank will charge fee as a commission. This will be the sole earning for the banks.
7) Payment bank will charge fee as a commission. This will be the sale earning for the banks.
8) Payment banks will also have to maintain CRR just like other scheduled commercial banks.

Chapter 05:- Financial Markets

Introduction:

A financial market links between these two different groups or it is an intermediary between lenders and borrowers of funds. Funds are borrowed by selling different financial assets or instruments such as shares, debentures, bonds, securities, bills of exchange, foreign currencies . . . etc.

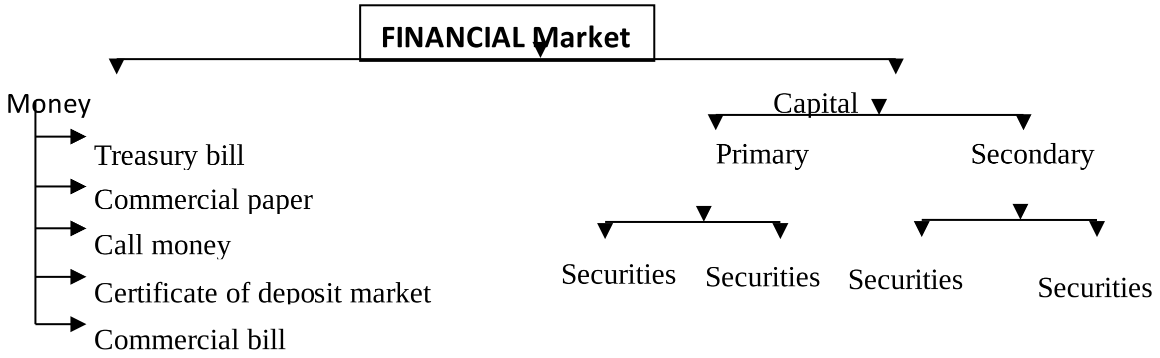
Meaning:

A financial markets consists of institutions that issues the instruments or securities for the purpose of raising funds. Those instruments or securities are called financial assets.

A financial market consists of two major components. They are

a) Money market

b) Capital market


FINANCIAL Market
Money
Treasury bill
Commercial paper
Call money
Certificate of deposit market
Commercial bill
Capital
Primary
Secondary
Securities
Securities
Securities
Securities

Distinction between Primary Market and Secondary Market:

No.	Primary Market	Secondary Market
1.	There is sale of securities by new companies or Existing companies.	There is trading of existing shares only.
2.	Securities are sold by the company to the investor directly	Ownership of existing securities is exchanged between investors.
3.	The flow of funds is from savers to investors.	Enhances encashability of shares.
4.	Only buying of securities takes place in The primary market.	Both the buying and selling of securities can take place on the stock exchange.
5.	Prices are determined and decided by the management of the company.	Prices are determined by demand and supply for the security.
6.	There is no fixed geographical location.	Located at specified places.

Money market

The money market is a market for short term funds which deals in monetary assets whose period of maturity is up to one year. These assets are close substitutes for money. It is a market where low risk, unsecured and short term debt instruments that are highly liquid are issued and actively traded every day. It has no physical location, but is an activity conducted over the telephone and through the internet. It enables the raising of short-term funds for meeting the temporary shortages of cash and obligations and the temporary deployment of excess funds for earning returns. The major participants in the market are the Reserve Bank of India.

According to the **Reserve Bank of India,** "A money market is the centre for dealings, mainly of short term characters in monetary assets; it means the short term requirements of borrowers and provides liquidity or cash to the lenders".

Money market consists of the following instruments:

a) **Treasury Bills:** A Treasury bill is an instrument of short-term borrowing by the Government of India maturing in less than one year (Generally the duration varies from 14 days to 364 days). These bills are in the nature of promissory notes. They are highly liquid, having assured return and negligible risk, they are issued at a price which is lower than their face value.

b) **Call Money:** Call Money is a method by which banks faced with temporary shortage of cash borrow short-term finance from other banks. Maturity period of call money is very short i.e., one day to fifteen days. When Reserve Bank of India changes CRR (Cash Reserve Ratio) from time to time, it affects the amounts of funds available to be given as loans by commercial banks.

c) **Certificate of Deposit:** These are short-term, unsecured negotiable instruments in bearer form issued by commercial banks. They can be issued to individuals, corporations and companies. The certificate bears the maturity date, the fixed rate of interest and the maturity value.

d) **Commercial Papers:** The commercial paper was introduced in 1990 as a money market instrument. Commercial paper is a short-term unsecured promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period issued by large and credit-worthy companies. It usually has a maturity period of fifteen days to one year. It is sold at a discount and redeemed at par.

e) **Commercial Bills:** Commercial Bills are short term, negotiable and self- liquidating money market instruments with low risk. It is a bill of exchange used to finance the working capital requirements of business organizations.

Capital Market:

The term capital market refers to facilities and institutional arrangements through which long-term funds, both debt and equity are raised and invested.

It consists of a series of channels through which savings of the community are made available for industrial and commercial enterprises and for the public in general. It directs these savings into their most productive use leading to growth and development of the economy. The capital market consists of development banks, commercial banks and stock exchanges. Capital market is a market for long-term funds, just as the money markers the market for short term funds. It refers to institutions and mechanism, whereby long and intermediate term funds are pooled and made available to individuals, business and government.

In short the market dealing in the long and medium term funds is known as capital market. It is a market for financial assets which have a period ranging between 1 to 25 years or more is termed as capital market.

These funds are utilised in making investment in fixed assets. The instruments dealt in capital market are stocks, shares, debentures, bonds and securities of the government.

The capital market consists of various players like companies, individual investors, institutional investors and various intermediaries like brokers, merchant bankers, lead managers etc. These intermediaries facilitate the capital issues and other transactions in the capital market.

As stated earlier capital market has two important components:

a) **Primary Capital Market:** It is also known as New Issue Market. It mobilizes the funds from the investors by directly issuing the new securities. The funds are raised through shares, debentures and bonds by companies or financial institutions. A company can raise capital through the primary market in the form of equity shares, preference shares, debentures, loans and deposits. Funds raised may be for setting up new projects, expansion, diversification, modernization of existing projects, mergers and takeovers etc.

Methods of flotation

1. **Offer through Prospectus**: Offer through prospectus is the most popular method of raising funds by public companies in the primary market. This involves inviting subscription from the public through issue of prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines. The issues may be underwritten and also are required to be listed on at least one stock exchange.
2. **Offer for Sale**: Under this method securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers.
3. **Private Placement**: Private placement is the allotment of securities by a company to institutional investors and some selected individuals. It helps to raise capital more quickly than a public issue.

Access to the primary market can be expensive on account of various mandatory and non-mandatory expenses.

4. **Rights Issue**: This is a privilege given to existing shareholders to subscribe to a new issue of shares according to the terms and conditions of the company. The shareholders are offered the 'right' to buy new shares in proportion to the number of shares they already possess.
5. **E-IPOs**: A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the stock exchange. This is called an Initial Public Offer (IPO).

Secondary Capital Market:

It is also known as stock market or stock exchange. It is a market for the purchase and sale of second hand or existing securities. This market creates liquidity and easy marketability to the securities. It consists of recognised stock exchanges operating under rules, bye laws and regulations duly approved by the government.

The secondary market is also known as the stock market or stock exchange. It is a market for the purchase and sale of existing securities. It helps existing investors to disinvest and fresh investors to enter the market. It also provides liquidity and marketability to existing securities. It also contributes to economic growth by channelising funds towards the most productive investments through the process of disinvestment and reinvestment. Securities are traded, cleared and settled within the regulatory framework prescribed by SEBI.

Distinction between Money Market and Capital Market:

No.	Money Market	Capital Market
1.	A market where short- term funds are borrowed and lent.	A market where long- term funds are borrowed and lent.
2.	The instruments involved for transactions are: Treasury Bills, Call Money, Certificate of Deposit, Commercial Papers, Commercial Bills etc.	The instruments involved for transactions are: Stocks, Shares, Debentures, Bonds & Government securities.
3.	The major players are: RBI, Commercial Banks, and Financial Institutions.	The major players are: Companies; Individual investors, Institutional Investors, Foreign Investors, and Banks & Financial Institutions.
4.	Instruments are highly liquid.	Instruments are relatively less liquid.
5.	Rate of return is low.	Rate of return is high.
6.	Very low financial risk.	Very high financial risk.
7.	It arranges small amount of funds.	It arranges large amount of funds\

Stock Exchange

A stock exchange is an institution which provides a platform for buying and selling of existing securities. Stock Exchange is an important constituent of Capital Market. It is an organized market for the purchase and sale of government and listed industrial and financial securities. Securities consist of shares, debentures of companies and bonds and debentures issued by government, public corporation, municipal and port trust bodies.

It is a convenient place where trading in securities is conducted in a systematic manner i.e., under a code of rules and regulations. It is an investment intermediary and helps companies to raise finance, provide liquidity and safety of investment to the investors and enhance credit worthiness of individual companies. As a market, the stock exchange facilitates the exchange of a security (share, debenture etc.) into money and vice versa. Stock exchanges help companies raise finance, provide liquidity and safety of investment to the investors and enhance the credit worthiness of individual companies.

Definition:

The Securities Contracts [Regulation] Act, 1956, defines a stock exchange as "an association, or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling of business in buying, selling and dealing in securities".

Functions of Stock Exchange:

1. **Providing Liquidity and Marketability to Existing Securities:** The basic function of a stock exchange is the creation of a continuous market where securities are bought and sold. It gives investors the chance to disinvest and reinvest.
2. **Pricing of Securities:** Share prices on a stock exchange are determined by the forces of demand and supply. A stock exchange is a mechanism of constant valuation through which the prices of securities are determined.
3. **Safety of Transaction**: The membership of a stock exchange is well regulated and its dealings are well defined according to the existing legal framework. This ensures that the investing public gets a safe and fair deal on the market.
4. **Contributes to Economic Growth:** A stock exchange is a market in which existing securities are resold or traded. Through this process of disinvestment and reinvestment savings get channelized into their most productive investment avenues. This leads to capital formation and economic growth.
5. **Spreading of Equity Cult**: The stock exchange can play a vital role in ensuring wider share ownership by regulating new issues, better trading practices and taking effective steps in educating the public about investments.
6. **Providing Scope for Speculation**: The stock exchange provides sufficient scope within the provisions of law for speculative activity in a restricted and controlled manner. It is generally accepted that a certain degree of healthy speculation is necessary to ensure liquidity and price continuity in the stock market.

Trading Procedure

Till a few years ago trading on a stock exchange took place through a public outcry or auction system. This has been replaced by an online screen based electronic trading system as almost all exchanges have become electronic.

Trading has, therefore, shifted from the stock market floor to the brokers' office where trades are executed through a computer. Brokers are members of a stock exchange through whom trading of securities is done. Brokers may be individuals, partnership firms or corporate bodies. They are the intermediaries between the buyers and sellers. Earlier these members owned, controlled and managed the exchanges.

The ownership and management of stock exchanges by brokers often led to a conflict of interest between the brokers and their clients. This led to 'demutualisation' of stock exchanges. **Demutualisation** separates the ownership and control of stock exchanges from the trading rights of members. This reduces the conflict of interest between the exchange and the brokers and the chances of brokers using stock exchanges for personal gains.

Dematerialisation of securities: A share certificate is proof of ownership of securities by an individual. Purchase and sale transactions in securities involved the exchange of money in return for the share certificate. This led to problems of theft, forgery, transfer delays and time involved in paperwork. To eliminate these problems an electronic book entry form of holding and transferring securities has been introduced. This is referred to as 'dematerialisation of securities'.

Advantages of Online Trading:

1. It ensures transparency as it allows participants to see the prices of all securities in the market while business is being transacted. They are able to see the full market during real time.
2. It increases efficiency of information being passed on, thus helping in fixing prices efficiently. The computer screens display information on prices and also capital market developments that influence share prices.
3. It increases the efficiency of operations, since there is reduction in time, cost and risk of error.
4. People from all over the country and even abroad who wish to participate in the stick market can buy or sell securities through brokers or members without knowing each other. That is, they can sit in the broker's office, log on to the computer at the same time and buy or sell securities. This system has enabled a large number of participants to trade with each other, thereby improving the liquidity of the market.
5. A single trading platform has been provided as business is transacted at the same time in all the trading centres. Thus, all the trading centres spread all over the country have been brought onto one trading platform, i.e., the stock exchange, on the computer.

STEPS IN THE TRADING AND SETTLEMENT PROCEDURE:

The following steps are involved in the screen-based trading for buying and selling of securities:

1. If an investor wishes to buy or sell any security he has to first approach registered broker or sub-broker and enter into an agreement with him. The investor has to sign a broker-client agreement and a client registration from before placing an order to buy or sell securities. He has also to provide certain other details and information. These include:

    - PAN number (This is mandatory).
    - Date of birth and address.
    - Educational qualification and occupation.
    - Residential status (Indian/NRI).
    - Bank account details.
    - Depository account details.
    - Name of any other broker with whom registered.
    - Client code number in the client registration form.
    - The broker then opens a trading account in the name of the investor.

2. The investor has to open a 'demat' account or 'beneficial owner' (BO) account with a depository participant (DP) for holding and transferring securities in the demat form. He will also have to open a bank account for cash transactions in the securities market.
3. The investor then places an order with the broker to buy or sell shares. Clear instructions have to be given about the number of shares and the prices at which the shares should be bought or sold. The broker will then go ahead with the deal at the above mentioned prices or the best price available. An order confirmation slip is issued to the investor by the broker.
4. The broker then will go on-line and connect to the main stock exchange and match the share and best price available.
5. When the shares can be bought or sold at the price mentioned, it will be communicated to the broker's terminal and the order will be executed electronically. The broker will issue a trade confirmation slip to the investor.
6. After the trade has been executed within 24 hours the broker issues a Contract Note. This note contains details of the number of shares bought or sold, the price, the date and time of deal, and the brokerage charges. This is an important document as it is legally enforceable and helps to settle disputes/claims between the investor and the broker. A Unique order code number is assigned to each transaction by the stock exchange and is printed on the contract note.
7. Now, the investor has to deliver the shares sold or pay cash for the shares bought. This should be done immediately after receiving the contract note or before the day when the broker shall make payment or delivery of shares to the exchange. This is called the pay-in-day.
8. Cash is paid or securities are delivered on pay-in day, which is before the T+2 day as the deal has to be settled and finalised on the T+2 day. The settlement cycle is on T+2 day on a rolling settlement basis, w.e.f. 1April 2003.

9. On the T+2 day, the exchange will deliver the share or make payment to the other broker. This is called the pay-out day. The broker then has to make payment to the investor within 24 hours of the pay-out since he has already received payment from the exchange.
10. The broker can make delivery of shares in demat form directly to the investor's demat account. The investor has to give details of his demat account and instruct his depository participant to take delivery of securities directly in his beneficial owner account.

WORKING OF THE DEMAT SYSTEM

1. A depository participant (DP) either a bank, broker or financial services company, may be identified.
2. An account opening form and documentation (PAN card details, photograph, power of attorney) may be completed.
3. The physical certificate is to be given to the DP along with a dematerialization request form.
4. If shares are applied in a public offer, simple details of DP and demat account are to be given and the shares on allotment would automatically be credited to the demat account.
5. If shares are to be sold through a broker, the DP is to be instructed to debit the account with the number of shares.
6. The broker then gives instruction to his DP for delivery of the shares to the stock exchange.
7. The broker then receives payment and pays the person for the shares sold.
8. All these transactions are to be completed within 2 days, i.e., delivery of shares and payment received from the buyer is on a T+2 bases, settlement period.

NATIONAL STOCK EXCHANGE OF INDIA (NSE)

The National Stock Exchange is the latest, most modern and technology driven exchange. It was incorporated in 1992 and was recognised as a stock exchange in April 1993. It started operations in 1994, with trading on the wholesale debt market segment. Subsequently, it launched the capital market segment in November 1994 as a trading platform for equities and the futures and options segment in June 2000 for various derivative instruments. NSE has set up a nationwide fully automated screen based trading system. The NSE was setup by leading financial institutions, banks, insurance companies and other financial intermediaries.

OBJECTIVES OF NSE

1. Establishing a nationwide trading facility for all types of securities.
2. Ensuring equal access to investors all over the country through an appropriate communication network.
3. Providing a fair, efficient and transparent securities market using electronic trading system.
4. Enabling shorter settlement cycles and book entry settlements.
5. Meeting international benchmarks and standards.

MARKET SEGMENTS OF NSE

1. **Whole Sale Debt Market Segment:** This segment provides a trading platform for a wide range of fixed income securities that include central government securities, treasury bills, state development loans, bonds issued by public sector undertakings, floating rate bonds, zero coupon bonds, index bonds, commercial paper, certificate of deposit, corporate debentures and mutual funds.

2. **Capital Market Segment**: The capital market segment of NSE provides an efficient and transparent platform for trading in equity, preference, debentures, exchange traded funds as well as retail Government securities.

OVER THE COUNTER EXCHANGE OF INDIA (OTCEI)

The OTCEI is a company incorporated under the Companies Act 1956. It was set-up to provide small and medium companies an access to the capital market for raising finance in a cost effective manner. It was also meant to provide investors with a convenient, transparent and efficient avenue for capital market investment. It is fully computerised, transparent, single window exchange ‘which commenced trading in 1992. This exchange is established on the lines of NASDAQ (National Association of Securities Dealers Automated Quotations) the OTC exchange in USA. It has been promoted by UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Capital markets and Can Bank Financial Services.

The objectives of OTCEI are to provide quicker liquidity to securities at a fixed and fair price, liquidity for less traded securities or that of small companies, a simplified process of buying and selling and easy and cheaper means of making public sale of new issues.

Advantages of OTC Market

1. It provides a trading platform to smaller and less liquid companies as they are not eligible for listing on a regular exchange.
2. It is a cost effective method for corporates as there is a lower cost of new issues and lower expenses of servicing the investors.
3. Family concerns and closely held companies can go public through OTC.
4. Dealers can operate both in new issues and secondary market at their option.
5. It gives greater freedom of choice to investors to choose stocks by dealers for market making in both primary and secondary markets.
6. It is a transparent system of trading with no problem of bad or short deliveries.
7. Information flows are free and more direct from market makers to customers since there is close contact between them.

Insider Trading:- It is the illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information. Insider trading refers to the trading of securities by corporate insiders such as managers or executives.

Insider trading can be legal or illegal depending on if the information used to base the trade is public. This illegal buying and selling of company shares by people who have special information because they are involved with the company.

Short Selling in Trade: - It is defined as selling a stock which the seller does not own at the time of trade. All classes of investors, Viz., retail and institutional investors, are permitted to short sell. The short selling is part and parcel of stock markets wherein many traders sell various stocks without having physical delivery of such shares with the expectation that the prices would fall and they would buy it back at lesser price and make some profits.

Stock Brokers: - A stockbroker is a professional trader who buys and sells shares on behalf of clients. The stockbroker may also be known as a registered representative or an investment advisor. Most stockbrokers work for a brokerage firm and handle transactions for a number of individual and institutional customers.

Speculation:- Speculation, or speculative trading, refers to the act of conducting a financial transaction that has substantial risk of losing value but also holds the expectation of a significant gain or other major value.