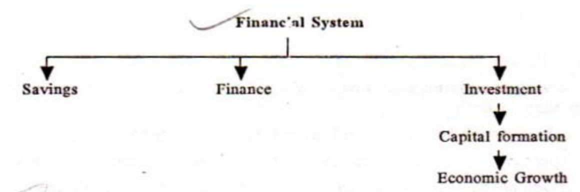
FINANCIALSYSTEM

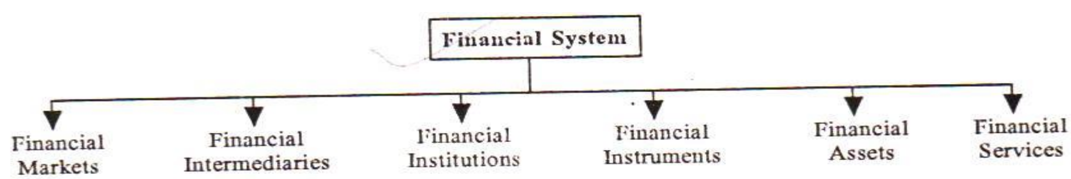
DEFINITION:

The term financial system is a set of interrelated activities/services working together to achieve some predetermined purpose or goal. It includes different markets/institutions/instruments/ services and mechanisms which influence the generation of savings/investment/capital formation and growth. According to Robinson, the primary function of the system 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."

Hence the primary function of the financial system is the mobilization of savings. Their distribution for individual investment and stimulating capital formation to accelerate the process of economic growth. It can be shown as under —



The process of savings/finance and investment involves financial institutions/markets/instruments/ intermediaries and services. Thus, financial management is an integral part of the financial system.



The financial system consists of many institutions/instruments and markets. Financial instruments range from moneylenders to banks pension funds/insurance companies/brokerage houses/investment trusts and stock exchanges. Financial instruments range from the common currency/cheques/ mortgages/debentures/bonds and share to the more exotic — futures and swaps of high finance,

The understanding of the financial system requires an understanding of the following important concepts:

- There is no specific place or location to indicate a financial market.
- Where the financial transactions takes place, that one is called financial market.
- However, financial market can be referred to those centres and arrangements, which facilitate buying and selling of financial assets, claims and services.

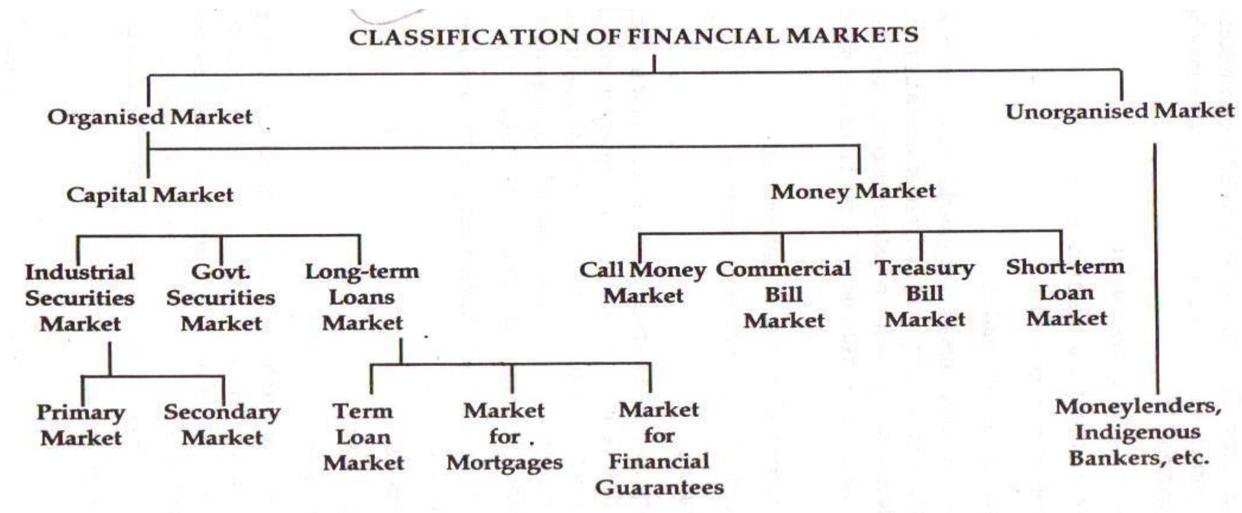
The Financial markets are of two types.

Unorganized market	Organized market
➢ Informal	➢ Formal

➢ No standardised rules & regulation ➢ No role of RBI	➢ Standardised rules and regulation ➢ Controlled by RBI

Organized market again classified into two

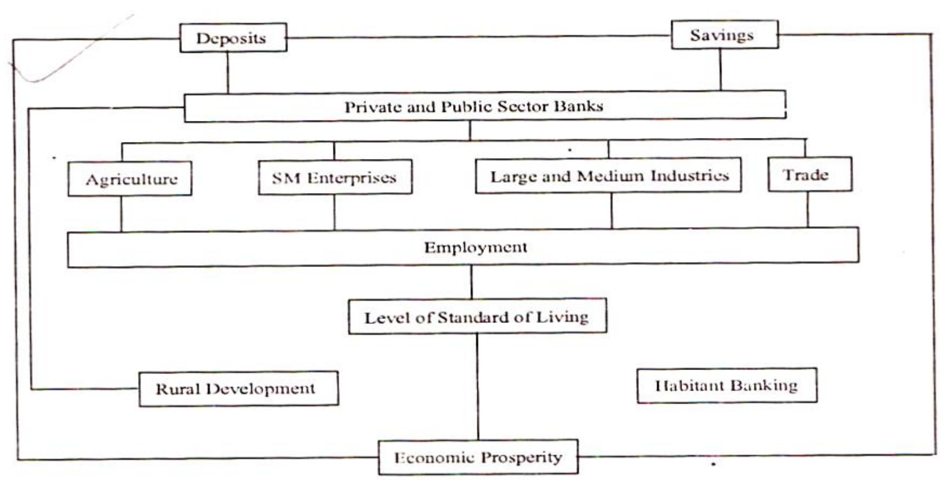
a. Money Market
b. Capital Market



Financial System and Economic Development

The Indian financial system comprises of an impressive network of banks, other financial and investment institutions, offering wide range of products and services, which together function in fairly developed capital and money markets. As such, financial system has come to occupy an important role in the process of economic development.

The economic development of a country depends inter alia, on its financial structure. In the long-run, the larger the proportion of financial assets to real assets; the greater the scope for economic growth. Since finance is an important input in the growth process it has a crucial role to play in the economy. The increasing rate of savings is correlated with the increase in the proportion of savings held in the form of financial assets relative to tangible assets.



The major function of financial institutions, whether short-term or long-term, is to provide the maximum financial convenience to the public. This maybe done in three ways:

(i) Promoting the overall savings of the economy by widening the financial structure;
(ii) Distributing the existing savings in a more efficient manner.
(iii) Creating credit and deposit money and facilitating the transactions of trade, production and distribution in furtherance of the economy.

FINANCIAL SYSTEM AND ECONOMIC DEVELOPMENT

The financial system plays a significant role in the process of economic development of a country. They play a crucial role in spurring economic growth in the following ways:

(i) Mobilizing savings: The financial system mobilizes the savings of the people by offering appropriate incentives and by widening the financial structure. In other words, the financial system creates varieties of forms of savings so that savings can take place according to the varying asset preferences of different classes of savers. In the absence of the financial system, all savings would remain idle in the hands of the savers and they would not have flown into productive ventures.

(ii) Promoting investments: For the economic growth of any nation, investment is absolutely essential. This investment has to flow from the financial system. In fact, the level of investment determines the increase in output of goods and services and incomes in the country. The financial system collects the savings and channels them into investment which contributes positively towards economic development.

(iii) Encouraging investment in financial assets: The dynamic role of the financial system in the economic development is that it encourages savings to flow into financial assets (money and monetary assets) as against physical assets (land, gold and other goods and services). The investments in physical assets are speculative and would breed inflation. On the other hand, investments in financial assets are non-inflationary in nature and would aid growth in the economy. The larger the proportion of the financial assets, the greater is the scope for economic growth in the long-run.

(iv) Allocating savings on the basis of national priorities: Above all, the financial system allocates the savings in a more efficient manner so that the scarce capital may be more efficiently utilized among the various alternative investments. In other words, it gives preference to certain sectors, from the social and economic point of view, on the basis of national priorities.

(v) Creating credit: Large financial resources are needed for the economic development of a nation. These resources are supplied by the financial system not only in the form of liquid cash but also in the form of 'created money' or 'deposit money' by creating credit and thereby making available large resources to finance trade, production, distribution, etc. Thus, it accelerates economic growth by facilitating the transactions of trade, production and distribution on a large-scale.

(vi) Providing a spectrum of financial assets: The financial system provides a spectrum of financial assets so as to meet the varied requirements and preferences of households. Thus, it enables them to choose their asset portfolios in such a way as to achieve a preferred mix of return, liquidity and risk. Thus, it contributes to the economic development of a country.

(vii) Financing trade, industry and agriculture: All the financial institutions operating in a financial system take all efforts to ensure that no worthwhile project — be it in trade or agriculture or industry — suffers due to lack of funds. Thus, they promote industrial and agricultural development which have a greater say on the economic development of a country.

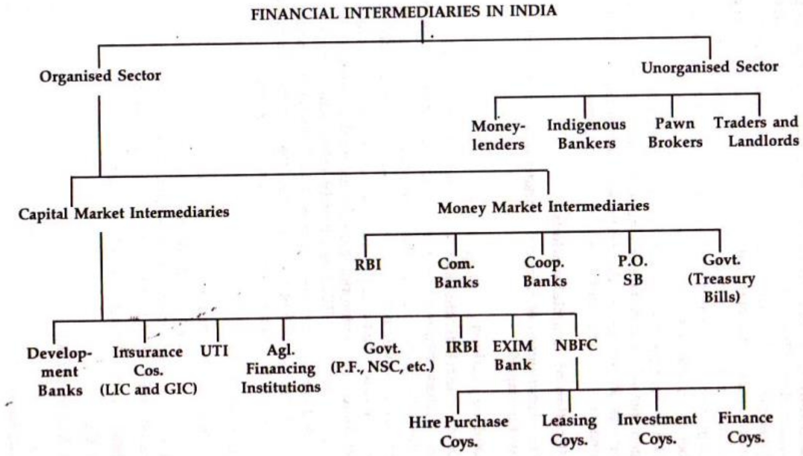
(viii) Encouraging entrepreneurial talents: The financial institutions encourage the managerial and entrepreneurial talents in the economy by promoting the spirit of enterprise and risk-taking capacity. They also furnish the necessary technical consultancy services to the entrepreneurs so that they may succeed in their innovative ventures.

(ix) Providing financial services: Sophistication and innovations have started appearing in the arena of financial intermediation as well. The financial institutions play a very dynamic role in the economic development of a country not only as a provider of finance, but also as a departmental store of finance by offering varieties of innovative financial products and services to meet the ever-increasing demands of their clients both corporate and individuals.

(x) Developing backward areas: The integral policy of the national development plans of every country concentrates on the development of relatively less developed areas called backward areas. The financial institutions provide a package of services, infrastructure and incentives conducive to a healthy growth of industries in such backward areas and thus, they contribute for the uniform development of all regions in a country.

CHART 1.2

FINANCIAL INTERMEDIARIES IN INDIA



FINANCIAL INTERMEDIARIES

The term financial intermediary includes all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers. Thus, it refers to all kinds of financial institutions and investing institutions which facilitate financial transactions in financial markets. They may be in the organised sector or in the unorganized sector They may also be classified into two:

(i) Capital market intermediaries.
(ii) Money market intermediaries.

Capital market intermediaries

These intermediaries mainly provide long-term funds to individuals and corporate customers. They consist of term lending institutions like financial corporations and investing institutions like LIC.

Money market intermediaries

Money market intermediaries supply only short-term funds to individuals and corporate customers. They consist of commercial banks, co-operative banks, etc.

OVERVIEW OF INDIAN FINANCIAL SYSTEM

Some serious attention was paid to the development of a sound financial system in India only after the launching of the planning era in the country. At the time of Independence in 1947, there was no strong financial institutional mechanism in the country. There was absence of issuing institutions and non-participation of intermediary financial institutions. The industrial sector also had no access to the savings of the community. The capital market was very primitive and shy. The private as well as the unorganised sector played a key role in the provision of 'liquidity'. On the whole, chaotic conditions prevailed in the system.

With the adoption of the theory of mixed economy, the development of the financial system took a different turn so as to fulfill the socio-economic and political objectives. The Government started creating new financial institutions to supply finance both for agricultural and industrial development and it also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction.

Nationalisation of Financial Institutions

As stated earlier, the RBI is the leader of the financial system. But, it was established as a private institution in 1935. It was nationalised in 1948. It was followed by the nationalisation of the Imperial Bank of India in 1956 by renaming it as State Bank of India.

In the same year, 245 Life Insurance Companies were brought under Government control by merging all of them into a single corporation called Life Insurance Corporation of India. Another significant development in our financial system was the nationalisation of 14 major commercial banks in 1969. Again, six banks were nationalised in 1980. This process was then extended to General Insurance Companies which were reorganised under the name of General Insurance Corporation of India. Thus, the important financial institutions were brought under public control.

Banking

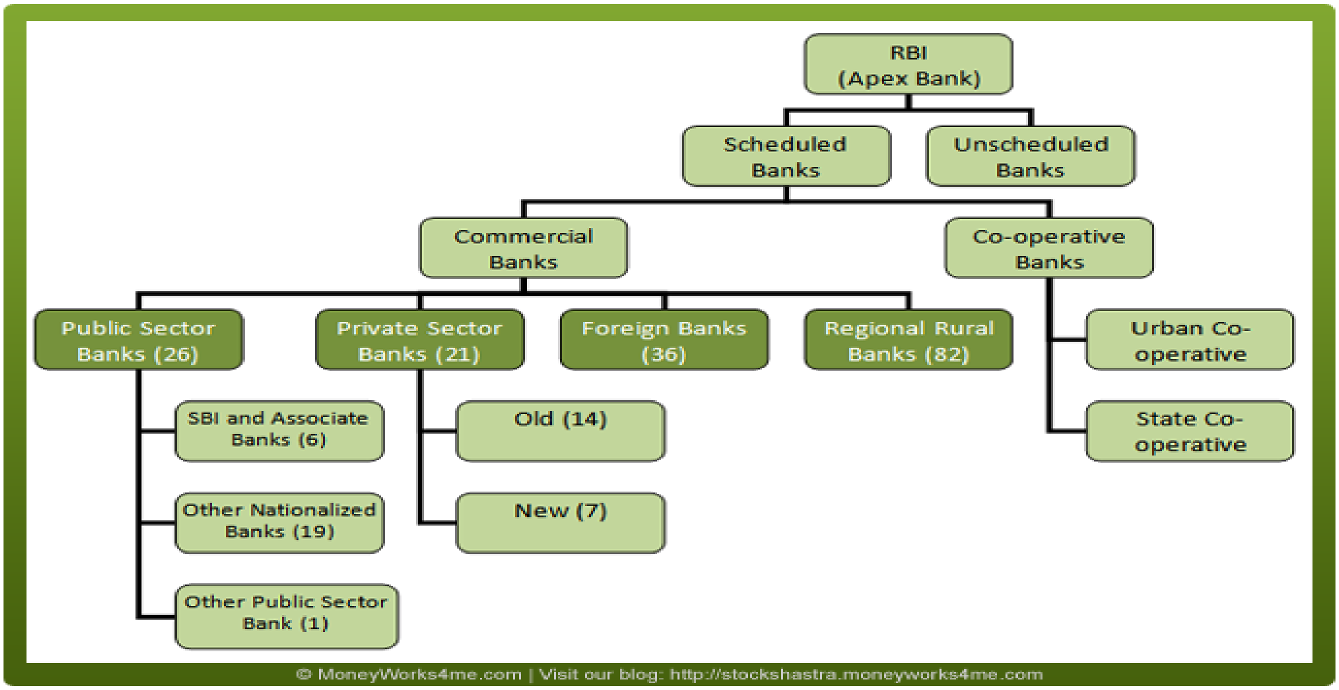
Historical Perspective of Banking, An Overview of development of Banking in India

Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India, which started in 1786, and which started in 1790; both are now defunct. The oldest bank in existence in India is the which originated in the June 1806, which almost immediately became the This was one of the three presidency banks, the other two being the, all three of which were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 to form the which, upon India's independence, became the in 1955.

Banking Structure

Banking Regulator

The Reserve Bank of India (RBI) is the central banking and monetary authority of India, and also acts as the regulator and supervisor of commercial banks.



Scheduled Banks in India

Scheduled banks comprise scheduled commercial banks and scheduled co-operative banks. Scheduled commercial banks form the bedrock of the Indian financial system, currently accounting for more than three-fourths of all financial institutions' assets. SCBs are present throughout India, and their branches, having grown more than four-fold in the last 40 years now number more than 80,500 across the country. Our focus in this module will be only on the scheduled commercial banks.

Public Sector Banks

Public sector banks are those in which the majority stake is held by the Government of India (GoI). Public sector banks together make up the largest category in the Indian banking system. There are currently 27 public sector banks in India. They include the SBI and its 6 associate banks (such as State Bank of Indore, State Bank of Bikaner and Jaipur etc), 19 nationalised banks (such as Allahabad Bank, Canara Bank etc) and IDBI Bank Ltd. Public sector banks have taken the lead role in branch expansion, particularly in the rural areas.

Regional Rural Banks

Regional Rural Banks (RRBs) were established during 1976-1987 with a view to develop the rural economy. Each RRB is owned jointly by the Central Government, concerned State Government and a sponsoring public sector commercial bank. RRBs provide credit to small farmers, artisans, small entrepreneurs and agricultural labourers. Over the years, the Government has introduced a number of measures of improve viability and profitability of RRBs, one of them being the amalgamation of the RRBs of the same sponsored bank within a State. This process of consolidation has resulted in a steep decline in the total number of RRBs to 82 as on March 31, 2009, as compared to 196 at the end of March 2005.

Private Sector Banks

In this type of banks, the majority of share capital is held by private individuals and corporates. Not all private sector banks were nationalized in 1969, and 1980. The private banks which were not nationalized are collectively known as the old private sector banks and include banks such as The Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd etc. Entry of private sector banks was however prohibited during the post-nationalization period. In July 1993, as part of the banking reform process and as a measure to induce competition in the banking sector, RBI permitted the private sector to enter into the banking system. This resulted in the creation of a new set of private sector banks, which are collectively known as the new private sector banks. As at end March, 2009 there were 7 new private sector banks and 14 old private sector banks operating in India.

Foreign Banks

Foreign banks have their registered and head offices in a foreign country but operate their branches in India. The RBI permits these banks to operate either through branches; or through wholly-owned subsidiaries. The primary activity of most foreign banks in India has been in the corporate segment. However, some of the larger foreign banks have also made consumer financing a significant part of their portfolios. These banks offer products such as automobile finance, home loans, credit cards, household consumer finance etc. Foreign banks in India are required to adhere to all banking regulations, including priority-sector lending norms as applicable to domestic banks. In addition to the entry of the new private banks in the mid-90s, the increased presence of foreign banks in India has also contributed to boosting competition in the banking sector.

Co-operative Banks

Co-operative banks cater to the financing needs of agriculture, retail trade, small industry and self-employed businessmen in urban, semi-urban and rural areas of India. A distinctive feature of the co-operative credit structure in India is its heterogeneity. The structure differs across urban and rural areas, across states and loan maturities. Urban areas are served by urban cooperative banks (UCBs), whose operations are either limited to one state or stretch across states. The rural co-operative banks comprise State co-operative banks, district central cooperative banks.

The co-operative banking sector is the oldest segment of the Indian banking system. The network of UCBs in India consisted of 1721 banks as at end-March 2009, while the number of rural co-operative banks was 1119 as at end-March 2008. Owing to their widespread geographical penetration, cooperative banks have the potential to become an important instrument for large-scale financial inclusion, provided they are financially strengthened. The RBI and the National Agriculture and Rural Development Bank (NABARD) have taken a number of measures in recent years to improve financial soundness of co-operative banks.

Topic -3: The Banking Sector:

In the banking sector RBI act as a central bank of the country and bankers bank. Under RBI , the whole structure of bank in India can be broadly classified in two parts i.e.

I. Commercial Banks
II. Cooperative Banks

Commercial banks can be further classified in to three i.e.

I. Public Sector Banks
II. Private Sector Banks
III. Foreign Banks

I. Public Sector Banks are those where ownership of Govt. is more than 50%. They are also known as Govt. Banks. These banks can also be divided into following three categories.

> i. **Nationalized Banks-** 14 banks were nationalized in 1969 and 6 more banks were nationalized subsequently. In all these banks Govt. ownership is more than 51% and hence they are known as Govt. of India undertakings.
>
> ii. **SBI Group i.e.** State Bank of India and its subsidiaries **–** State Bank of India was nationalized in 1955 which was earlier known as imperial Bank of India. Six more subsidiaries of SBI were formed subsequently like State Bank of Indore, State Bank of Bikaner & Jaipur, State Bank of Travankore & Kochin etc.
>
> iii. **Regional Rural Banks-** These banks were created after passing RRB Act, 1974 to supplement the efforts of cooperative credit institutions to meet the demand of credit in rural areas and to provide them banking facilities.

III. **Private Sector Banks-** In India we have large number of Private Sector Banks. Prominent banks in this sector are ICICI Bank , HDFC Bank, Kotak Mahindra Bank etc.

IV. **Foreign Banks-** We have many foreign banks like ABN Amro, American Express, Standard Chartered Bank etc.

Emergence and Importance of Commercial banking:

The commercial banking industry in India started in 1786 with the establishment of the Bank of Bengal in Calcutta. The Indian Government at the time established three Presidency banks, viz., the Bank of Bengal (established in 1809), the Bank of Bombay (established in 1840) and the Bank of Madras (established in 1843). In 1921, the three residency banks were amalgamated to form the Imperial Bank of India, which took up the role of a commercial bank, a bankers' bank and a banker to the Government. The Imperial Bank of India was established with mainly European shareholders. It was only with the establishment of Reserve Bank of India (RBI) as the central bank of the country in 1935, that the quasi-central banking role of the Imperial Bank of India came to an end.

In 1860, the concept of limited liability was introduced in Indian banking, resulting in the establishment of joint-stock banks. In 1865, the Allahabad Bank was established with purely Indian shareholders. Punjab National Bank came into being in 1895. Between 1906 and 1913, other banks like Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up.

After independence, the Government of India started taking steps to encourage the spread of banking in India. In order to serve the economy in general and the rural sector in particular, the All India Rural Credit Survey Committee recommended the creation of a state-partnered and state-sponsored bank taking over the Imperial Bank of India and integrating with it, the former state-owned and state-associate banks. Accordingly, State Bank of India (SBI) was constituted in 1955. Subsequently in 1959, the State Bank of India (subsidiary bank) Act was passed, enabling the SBI to take over eight former state-associate banks as its subsidiaries.

To better align the banking system to the needs of planning and economic policy, it was considered necessary to have social control over banks. In 1969, 14 of the major private sector banks were nationalized. This was an important milestone in the history of Indian banking. This was followed by the nationalization of another six private banks in 1980. With the nationalization of these banks, the major segment of the banking sector came under the control of the Government. The nationalization of banks imparted major impetus to branch expansion in un-banked rural and semi-urban areas, which in turn resulted in huge deposit mobilization, thereby giving boost to the overall savings rate of the economy. It also resulted in scaling up of lending to agriculture and its allied sectors. However, this arrangement also saw some weaknesses like reduced bank profitability, weak capital bases, and banks getting burdened with large non-performing assets.

To create a strong and competitive banking system, a number of reform measures were initiated in early 1990s. The thrust of the reforms was on increasing operational efficiency, strengthening supervision over banks, creating competitive conditions and developing technological and institutional infrastructure. These measures led to the improvement in the financial health, soundness and efficiency of the banking system. One important feature of the reforms of the 1990s was that the entry of new private sector banks was permitted. Following this decision, new banks such as ICICI Bank, HDFC Bank, IDBI Bank and UTI Bank were set up.

Commercial banks in India have traditionally focused on meeting the short-term financial needs of industry, trade and agriculture. However, given the increasing sophistication and diversification of the Indian economy, the range of services extended by commercial banks has increased significantly, leading to an overlap with the functions performed by other financial institutions. Further, the share of long-term financing (in total bank financing) to meet capital goods and project-financing needs of industry has also increased over the years.

Functions of Commercial Banks

The main functions of a commercial bank can be segregated into three main areas: (i) Payment System (ii) Financial Intermediation (iii) Financial Services.

(i) Payment System

Banks are at the core of the payments system in an economy. A payment refers to the means by which financial transactions are settled. A fundamental method by which banks help in settling the financial transaction process is by issuing and paying cheques issued on behalf of customers. Further, in modern banking, the payments system also involves electronic banking, wire transfers, settlement of credit card transactions, etc. In all such transactions, banks play a critical role.

(ii) Financial Intermediation

The second principal function of a bank is to take different types of deposits from customers and then lend these funds to borrowers, in other words, financial intermediation. In financial terms, bank deposits represent the banks' liabilities, while loans disbursed, and investments made by banks are their assets. Bank deposits serve the useful purpose of addressing the needs of depositors, who want to ensure liquidity, safety as well as returns in the form of interest. On the other hand, bank loans and investments made by banks play an important function in channeling funds into profitable as well as socially productive uses.

(iii) Financial Services

In addition to acting as financial intermediaries, banks today are increasingly involved with offering customers a wide variety of financial services including investment banking, insurance-related services, government-related business, foreign exchange businesses, wealth management services, etc. Income from providing such services improves a bank's profitability.

Banker & Customer relationship-General and Special;

A banker is the one who gets into debts and creates debts. H.L. HART – the banker is one who receives money, collects cheques and drafts, for customers, with an obligation to honour the cheques drawn by customers from time to time subject to availability of amounts in the account.

Section 3 of NI ACT 1881, and Section 2 of BILL OF EXCHANGE ACT 1882 states that the term banker includes person or corporation or a company acting as banker. Under Section 5 (1) of Banking Regulations of 1949, a banking company is defined as any company which transacts banking business. Under Section 5 (1) B , banking business means accepting for the purpose of landing or investment, deposits of money from the public, repayable on demand or otherwise with drawable by cheque , draft or otherwise.

CUSTOMER: A person who buys goods or services from a shop or a business entity. A person you deal with as a business entity. There is no statutory definition. A person/ company/entity who has an account with a bank is a customer. There is no unanimity as regards to the time period of the dealings. A casual transaction like encashment of a cheque does not entail a person to be customer. The duration of association of the customer with the bank is of no essence. A customer is one who has an account with the bank and to whom the banks undertakes to extend business of banking.

RELATIONSHIP CREDITOR-DEBTOR: Relationship between the customer having a deposit account and the banker. Depositor is the lender and the banker is the borrower. Depositor is the creditor and the banker is the debtor. The money handed over to the bank is a debt. The money once deposited in the bank becomes the money of the bank and it is prerogative of the bank to use that money as it deems fit. The depositor remains a creditor that too an unsecured creditor

RELATIONSHIP DEBTOR-CREDITOR: When the customer avails a loan or an advance then his relationship with the banker undergoes a change to what it is when he is a deposit holder. Since the funds are lent to the customer, he becomes the borrower and the banker becomes the lender. The relation is the debtor- creditor relation, the customer being a debtor and the banker a creditor.

RELATIONSHIP BENEFICIARY-TRUSTEE: If a customer keeps certain valuables or securities with the bank for safe-keeping or deposits a certain amount of money for a specific purpose, the banker, besides becoming a bailee, is also a trustee. The money or the securities so kept are not at the disposal of the bank. The banker cannot utilize those moneys or securities as he desires since the money does not belong to him. Here there is delivery of goods or securities from one person to the other which amounts to the bailment. As per section 148 of Indian Contract Act 1872, the delivery of goods from one person to the other for some purpose upon the contract that the goods will be returned when the purpose is accomplished. The customer is the bailer and the banker is the bailee.

RELATIONSHIP PRINCIPAL-AGENT: Banks provide ancillary services such as collection of cheques, bills etc. They also undertake to pay regularly the electricity bills, phone bills etc. The relationship arising out of these ancillary services is of principal-agent between the customer and the bank. The relationship seizes once the customer dies, becomes insane or becomes insolvent. The proceeds of the cheques sent for collection, which are in transit, not created to the customer account are not the moneys of the banker till such time as they are credited into the customer account.

RELATIONSHIP LESSEE-LESSOR: The banks provide safe deposit lockers to the customers who hire them on lease basis. The relationship therefore, is that of lessee and lessor. In certain banks, this relationship is termed as licensee and licensor. The bank leases out the space for the use of clients. The bank is not responsible for any loss that arises to the lessee in this form of transaction except due to negligence of that bank.

Banking Services and the products there-under:
Various products offered by banks can be classified as retail banking product and corporate banking products.

Retail Banking Products- can be further classified as-

1. **Liability products**- Such as Savings, Current, Recurring, and Fixed Deposit Account.
2. **Asset Products**- loan like Housing, Personal, Education, Gold loan, Mortgage loan, Vehicle loan, Agricultural loans etc.
3. **Credit & Debit Cards**
4. **Investment Products**-Such as insurance plans, pension plans, mutual fund etc.

Corporate Banking Products-

1. Liability Products- Such as salary accounts of employees, current account, fixed deposit account, payment cards etc.

2. Asset Products-Such as trade finance in the form of cash credit (clear, pledge, hypothecation) short term loans, capital loans, letter of credit, guarantee, corporate finance, project finance etc

Various services provided by banks-

- Trusteeship services- Such as safe deposit, locker facilities

- ⇨ Money transfer facilities like Demand Draft EFT, RTGS, etc.
- ⇨ ATM facilities (debit card)
- ⇨ Project Guidance through project preparation and project finance
- ⇨ Demat account facilities
- ⇨ On-line banking
- ⇨ Consultancy & advisory services such as portfolio management etc.
- ⇨ E-banking/E-Commerce
- ⇨ Tele Banking
- ⇨ Foreign exchange services by authorized banks

Banking Regulations:

The Banking Regulation Act was passed as the Banking Companies Act 1949 and came into force w.e.f 16.3.49. Subsequently it was changed to Banking Regulations Act 1949 w.e.f 01.03.66. Summary of some important sections is provided hereunder. The section no. is given at the end of each item.

- Banking means accepting for the purpose of lending or investment of deposits of money from public repayable on demand or otherwise and withdrawable by cheque, drafts order or otherwise (5 (i) (b)).
- Banking company means any company which transacts the business of banking (5(i)(c)
- Transact banking business in India (5 (i) (e).
- Demand liabilities are the liabilities which must be met on demand and time liabilities means liabilities which are not demand liabilities (5(i)(f)
- Secured loan or advances means a loan or advance made on the security of asset the market value of which is not at any time less than the amount of such loan or advances and unsecured loan or advances means a loan or advance not secured (5(i)(h).
- Defines business a banking company may be engaged in like borrowing, lockers, letter of credit, travelers cheques, mortgages etc (6(1).
- States that no company shall engage in any form of business other than those referred in Section 6(1) (6(2).
- For banking companies carrying on banking business in India to use at least one word bank, banking, banking company in its name (7).
- Restrictions on business of certain kinds such as trading of goods etc. (8)
- Prohibits banks from holding any immovable property howsoever acquired except as acquired for its own use for a period exceeding 7 years from acquisition of the property. RBI may extend this period by five years (9)
- Prohibitions on employments like Chairman, Directors etc (10)
- Paid up capital, reserves and rules relating to these (11 & 12)
- Banks not to pay any commission, brokerage, discount etc. more than 2.5% of paid up value of one share (13)
- Prohibits a banking company from creating a charge upon any unpaid capital of the company. (14) Section 14(A) prohibits a banking company from creating a floating charge on the undertaking or any property of the company without the RBI permission.
- Prohibits payment of dividend by any bank until all of its capitalized expenses have been completely written off (15)
- To create reserve fund and 20% of the profits should be transferred to this fund before any dividend is declared (17 (1))
- Cash reserve - Non-scheduled banks to maintain 3% of the demand and time liabilities by way of cash reserves with itself or by way of balance in a current account with RBI (18)
- Permits banks to form subsidiary company for certain purposes (19)

- No banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owners of any amount exceeding 30% of its own paid up share capital + reserves or 30% of the paid up share capital of that company whichever is less. (19(2).
- Restrictions on banks to grant loan to person interested in management of the bank (20)
- Power to Reserve Bank to issue directive to banks to determine policy for advances (21)
- Every bank to maintain a percentage of its demand and time liabilities by way of cash, gold, unencumbered securities 25%-40% as on last Friday of 2nd preceding fortnight (24).
- Return of unclaimed deposits (10 years and above) (26)
- Every bank has to publish its balance sheet as on March 31st (29).
- Balance sheet is to be got audited from qualified auditors (30 (i))
- Publish balance sheet and auditors report within 3 months from the end of period to which they refer. RBI may extend the period by further three month (31)
- Prevents banks from producing any confidential information to any authority under Indian Disputes Act. (34A)
- RBI authorized to undertake inspection of banks (35).
- Amendment carried in the Act during 1983 empowers Central Govt to frame rules specifying the period for which a bank shall preserve its books (45-y), nomination facilities (45ZA to ZF) and return a paid instrument to a customer by keeping a true copy (45Z).
- Certain returns are also required to be sent to RBI by banks such as monthly return of liquid assets and liabilities (24-3), quarterly return of assets and liabilities in India (25), return of unclaimed deposits i.e. 10 years and above (26) and monthly return of assets and liabilities (27-1).

Retail credit-An overview:

It a financing method which provides loan services to retail consumers for goods and services. Retail credit facilities lend funds to consumers wishing to purchase high ticket items but are short on capital. Thus, retail credit facilities may enable a greater number of consumers access to a retailer's goods. Retail credit facilities can take the form of point of sale finance options in retail outlets. For example a Rs. 70,000 motorcycle might be a lot for a consumer to pay up front. Retail credit facilities will loan the Rs. 70,000 to the consumer, who will then pay it back with interest in monthly installments over several years. Some offer low or even no payments over an initial time period, but then charge above average interest. Retail credit facilities give the option of consuming now or consuming in the future. Higher interest rates may be acceptable to some consumers, depending on the consumers' unique consumption utilities. The risk of default is a factor that determines the interest rate that retail credit facilities charge.

RELATIONSHIP INDEMNIFIER- INDEMNIFIED: The customer is indemnifier and the bank is indemnified. A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or the conduct of any other person is called a contract of indemnity – section 124 (Indian Contract Act, 1872). In the case of banking, this relationship happens in transactions of issue of duplicate demand draft, fixed deposit receipt etc. The underlying point in these cases is that either party will compensate the other of any loss arising from the wrong/excess payment.

Basics of Insurance

INSURANCE: MEANING AND NATURE

The term insurance can be defined in financial as well as in legal terms. The financial definition deals with the funding or financial arrangement of the losses whereas the legal definition deals with provisions relating to legally enforceable contract.

DEFINITION IN FINANCIAL SENSE

Insurance is a financial arrangement, which redistributes the costs of unexpected losses among the members of the pool. The pool is a collection of people facing common risks. All members contribute a fixed amount towards a pool called premium. In exchange for the premium payment, the person gets an assurance that a certain sum of money is to be paid to him on the happening of the event insured against. The assurance is that his loss will be made good. Thus, insurance involves the transfer of loss exposures to an insurance pool and the redistribution of losses among the members of the pool.

DEFINITION IN LEGAL SENSE

Insurance can be defined as a contract between two parties by which one party undertakes to make good or indemnify any financial loss suffered by other party, in consideration of a sum of money, on the happening of a specified event e.g. fire, accident or death. We call the party agreeing to pay for the losses the insurer. We call the party whose loss makes the insurer pay the claim the insured. We call the payment insured pays to the insurer the premium. We call the insurance contract a policy. In the end we can sum up that insurance is a transfer of risk from the individual to the group and there is a sharing (pooling) of losses on some equitable basis such that fortuitous losses can be indemnified (paid).

NATURE OF INSURANCE

The insurance has the following characteristics, which are observed in case of life, marine, fire and general insurance.

(1) Sharing of risk - Insurance is a device to share the financial losses which might be falling on an individual or his family on the happening of a specified event. The event may be death in case of life insurance, fire in fire insurance etc. If insured the loss arising from these events will be shared by all insured in the form of premium.
(2) Co-operative device - The most important feature of every insurance plan is the cooperation of large number of persons who, in effect, agree to share the financial loss arising due to a particular risk which is insured. An insurer would be unable to compensate all losses from his capital. So, by insuring a large number of persons, he is able to pay the amount of loss.
(3) Value of risk - The risk is evaluated before insuring to charge the amount of share of an insured, premium. There are several methods of evaluation of risks. If there is expectation of more risk, higher premium may be charged. So, the probability of loss is calculated at the time of insurance.
(4) Payment at contingency - The payment is made at a certain contingency insured. If the contingency occurs, payment is made. Since the life insurance contract is a contract of certainty, because the contingency, the death or the expiry of term, will certainly occur, the payment is certain. In other insurance contracts, the contingency is the fire or the marine perils etc., may or may not occur. So, if the contingency occurs, payment is made, otherwise no amount is given to the policy-holder.
(5) Amount of payment - The amount of payment depends upon the value of loss occurred due to the particular insured risk provided insurance is there up to that amount. In life insurance, the purpose is not to make good the financial loss suffered. The insurer promises to pay a fixed sum on the happening of an event. If the event or the contingency takes place, the payment falls due if the policy is valid and in force at the time of the event.
(6) Large number of insured persons - To spread the loss immediately, smoothly and cheaply, large number of persons should be insured. Large number of persons or property is insured to lower the cost of insurance and the amount of premium.
(7) Insurance is not a gambling - The insurance serves indirectly to increase the productivity of the community by eliminating worry and increasing initiative. The uncertainty is changed into certainty by insuring property and life because the insurer promises to pay a definite sum at damage or death. From the company's point of view, the life insurance is essentially non-speculative; in fact, no other business operates with greater certainties. From the insured point of view, too, insurance is also the exact opposite of gambling. Nothing is more uncertain than life and life insurance offers the only sure method of changing that uncertainty into certainty.
(8) Insurance is not charity - Charity is given without consideration but insurance is not possible without premium. It provides security and safety to an individual and to the security although it is a kind of business because in consideration of premium it guarantees the payment of loss. It is a profession because it provides adequate sources at the time of disasters only by charging a nominal premium for the service.

PURPOSE AND NEED

Beside things mentioned by you, let's discuss in detail the purpose and need of insurance. As we all know life is full of uncertainties and insurance is based on uncertainties and if there are no uncertainties about the occurrence of a disaster, the concept of insurance will cease to exist. If we all are able to predict the future dangers correctly then we can take a safeguard action to move out of the danger but problem is that we cannot predict death, disaster and danger. All individuals as well as their tangible and intangible assets are exposed to all types of unforeseen risks. Thus insurance is done against such possible contingencies to save the owner and his family from all sorts of sufferings by making good the losses of the unfortunate few, through the help of the fortunate many, who were exposed to the same risk, but saved from the misfortune.

As insurance is a system of sharing risk that seems to be too great to be borne by one individual we can list out the benefits derived by individual and society from the insurance.

(1) Indemnifies loss - Insurance restores people to their former financial position as if no loss had occurred. It helps them to remain financially secure without running into debt after a loss. It also helps business firms to carry on their normal business operations without interruption even after the loss occurs.

(2) Reduces worry and fear - Insurance helps in reducing anxiety and fear before and after the loss occurs, as it is known that the insurance company will compensate the loss.

(3) Makes available funds for investment - Investments are the base of an economic development and mostly these investments are the result of savings. An insurance company is a major instrument for the mobilization of the savings of people, which are thereafter canalized into investment for economic growth. Insurance provides the continuity in trade and commerce, by covering the risks that could retard the economy and thereby indirectly helps the economy to grow.

(4) Provides employment to a large number of people – Insurance industry offers regular full time employment to a large number of people in the country. Besides them a number of agents, professionals etc. are also engaged by the industry to render professional services.

(5) Educates people about loss prevention - Insurance companies also engage themselves in educating people about loss prevention. In our country the GIC has created the loss prevention association of India to promote and propagate loss prevention.

(6) Insurance enhances credit worthiness - Insurance policies are often offered as collateral security for credit as well.

(7) Social benefits - Above all we derive social benefits when people with peaceful minds carry on their operations properly and in a better way. Thus insurance's contribution to the economy as a whole is valuable as it avoids economic hardships to people.

Topic -2: Historical perspectives (HISTORICAL BACKGROUND OF INSURANCE)

Life Insurance Corporation of India -The insurance sector in India dates back to 1818 when first insurance company, The Oriental Life Insurance Company, was established, at Calcutta. Thereafter, Bombay Life Assurance Company in 1823 and Madras Equitable Life Assurance Society in 1829, were established. In 1912, the Indian Life Assurance Companies Act was enacted as the first statute to regulate the life insurance business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life insurance businesses. The Insurance Act was subsequently reviewed and a comprehensive legislation was enacted called the Insurance Act, 1938. The nationalization of life insurance business took place in 1956 when 245 Indian and foreign insurance and provident societies were first amalgamated and then nationalized. The Life Insurance Corporation of India (LIC) came into existence by an Act of Parliament, viz. LIC act, 1956, with a capital contribution of Rs.5 Crores from the Government of India.

General Insurance Corporation Of India- The General insurance business in India started with the establishment of Triton Insurance Company Limited in 1850 at Calcutta .In 1907, the first company, The Mercantile Insurance Ltd. Was set up to transact all classes of general insurance business. General Insurance Council, a wing of the Insurance Association of India in 1957, framed a code of conduct for ensuring fair conduct and sound business practices. In 1968 the Insurance Act was amended to regulate investments and to set minimum solvency margins. In the same year the

Tariff Advisory Committee was also set up. In 1972, The General Insurance Business (Nationalization) Act was passed to nationalize the general insurance business in India with effect from 1st January 1973. For these 107 insurers was amalgamated and grouped into four company's viz., the National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd. And the United India Insurance Company Ltd. General Insurance Corporation of India was incorporated as a company.

CURRENT SCENARIO

In new economic policies formulated since 1991, globalization, privatization and liberalization have become new buzzwords. Under new economic policies, many economic and financial reforms took place. Like liberalizing licensing policy, attracting FDI, allowing foreign equity in public sector undertakings. The financial reforms restructured banking sector by allowing entry of new private and foreign banks. They also allowed private sector and commercial banks in mutual funds investment business, rationalizing the EXIM policy and so on.

Topic -3: Types of insurance

Any risk that can be quantified can potentially be insured. Specific kinds of risk that may give rise to claims are known as "perils". An insurance policy will set out in details which perils are covered by the policy and which are not. Below are (non-exhaustive) lists of the many different types of insurance that exist. A single policy may cover risks in one or more of the categories set out below. For example, auto insurance would typically cover both property risk (covering the risk of theft or damage to the car) and liability risk (covering legal claims from causing an accident).

1. Life insurance

Life insurance or life assurance is a contract between the policy owner and the where the insurer agrees to pay a designated beneficiary a sum of money upon the occurrence of the insured individual's or individuals' or other event, such as terminal illness or critical illness. In return, the policy owner agrees to pay a stipulated amount at regular intervals or in lump sums. There may be designs in some countries where bills and death expenses plus catering for after funeral expenses should be included in Policy Premium. In the United States, the predominant form simply specifies a lump sum to be paid on the insured's demise.

As with most policies, life insurance is a contract between the insurer and the policy owner whereby a benefit is paid to the designated if an insured event occurs which is covered by the policy. The value for the policyholder is derived, not from an actual claim event, rather it is the value derived from the 'peace of mind' experienced by the policyholder, due to the negating of adverse financial consequences caused by the death of the Life Assured. To be a life policy the insured event must be based upon the lives of the people named in the policy. Insured events that may be covered include: Serious. Life policies are legal contracts and the terms of the contract describe the limitations of the insured events. Specific exclusions are often written into the contract to limit the liability of the insurer; for example claims relating to suicide, fraud, war, riot and civil commotion.

Types of life insurance

Life insurance may be divided into two basic classes – temporary and permanent or following subclasses - term, universal, whole life and endowment life insurance.

Term Insurance

Term assurance provides life insurance coverage for a specified term of years in exchange for a specified The policy does not accumulate cash value. Term is generally considered "pure" insurance, where the premium buys protection in the event of death and nothing else.

There are three key factors to be considered in term insurance:

- Face amount (protection or death benefit),
- Premium to be paid (cost to the insured),
- Length of coverage (term).

Permanent Life Insurance

is life insurance that remains in force (in-line) until the policy matures (pays out), unless the owner fails to pay the premium when due (the policy expires OR policies lapse). The policy cannot be canceled by the insurer for any reason except fraud in the application, and that cancellation must occur within a period of time defined by law (usually two years). Permanent insurance builds a cash value that reduces the amount at risk to the insurance company and thus the insurance expense over time. This means that a policy with a million dollar face value can be relatively expensive to a 70 year old. The owner can access the money in the cash value by withdrawing money, borrowing the cash value, or surrendering the policy and receiving the surrender value. The four basic types of permanent insurance are whole life, universal life, limited pay and endowment.

Whole life coverage
provides for a level premium, and a cash value table included in the policy guaranteed by the company. The primary advantages of whole life are guaranteed death benefits; guaranteed cash values, fixed and known annual premiums, and mortality and expense charges will not reduce the cash value shown in the policy. The primary disadvantages of whole life are premium inflexibility, and the internal rate of return in the policy may not be competitive with other savings alternatives. Also, the cash values are generally kept by the insurance company at the time of death, the death benefit only to the beneficiaries. Riders are available that can allow one to increase the death benefit by paying additional premium. The death benefit can also be increased through the use of policy dividends. Dividends cannot be guaranteed and may be higher or lower than historical rates over time. Premiums are much higher than term insurance in the short-term, but cumulative premiums are roughly equal if policies are kept in force until average life expectancy.

Universal life coverage:
(UL) is a relatively new insurance product intended to provide permanent insurance coverage with greater flexibility in premium payment and the potential for a higher internal rate of return. There are several types of universal life insurance policies which include "interest sensitive" (also known as "traditional fixed universal life insurance"), variable universal life insurance, and equity indexed universal life insurance.

Limited-pay
Another type of permanent insurance is, in which all the premiums are paid over a specified period after which no additional premiums are due to keep the policy in force. Common limited pay periods include 10-year, 20-year, and paid-up at age 65.

Endowments
are policies in which the cash value built up inside the policy, equals the death benefit (face amount) at a certain age. The age this commences is known as the endowment age. Endowments are considerably more expensive (in terms of annual premiums) than either whole life or universal life because the premium paying period is shortened and the endowment date is earlier.

Accidental Death
Accidental death is a limited life insurance that is designed to cover the insured when they pass away due to an accident. Accidents include anything from an injury, but do not typically cover any deaths resulting from health problems or suicide. Because they only cover accidents, these policies are much less expensive than other life insurances. It is also very commonly offered as "", also known as an AD&D policy. In an AD&D policy, benefits are available not only for accidental death, but also for loss of limbs or bodily functions such as sight and hearing, etc.

Related Life Insurance Products
Riders are modifications to the insurance policy added at the same time the policy is issued. These riders change the basic policy to provide some feature desired by the policy owner. A common rider is accidental death, which used to be commonly referred to as "double indemnity", which pays twice the amount of the policy face value if death results from accidental causes, as if both a full coverage policy and an accidental death policy were in effect on the insured. Another common rider is premium waiver, which waives future premiums if the insured becomes disabled.

1. **Joint life insurance** is either a term or permanent policy insuring two or more lives with the proceeds payable on the first death or second death.

2. **Survivorship life**: is a whole life policy insuring two lives with the proceeds payable on the second (later) death.
3. **Single premium whole life**: is a policy with only one premium which is payable at the time the policy is issued.
4. **Modified whole life:** is a whole life policy that charges smaller premiums for a specified period of time after which the premiums increase for the remainder of the policy.
5. **Group life insurance:** is term insurance covering a group of people, usually employees of a company or members of a union or association. Individual proof of insurability is not normally a consideration in the underwriting. Rather, the underwriter considers the size and turnover of the group, and the financial strength of the group. Contract provisions will attempt to exclude the possibility of adverse selection. Group life insurance often has a provision that a member exiting the group has the right to buy individual insurance coverage.

2. General insurance

General insurance or non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event. General insurance typically comprises any insurance that is not determined to be. It is called and insurance in the and Non-Life Insurance in Continental Europe.

3. Health and medical insurance

Health insurance, like other forms of, is a form of by means of which people collectively pool their risk, in this case the risk of incurring medical expenses. The collective is usually publicly owned or else is organized on a non-profit basis for the members of the pool, though in some countries health insurance pools may also be managed by for-profit companies. It is sometimes used more broadly to include insurance covering or needs. It may be provided through a government-sponsored program, or from private insurance companies. It may be purchased on a group basis (e.g., by a firm to cover its employees) or purchased by an individual. In each case, the covered groups or individuals pay premiums or taxes to help protect themselves from unexpected healthcare expenses. Similar benefits paying for medical expenses may also be provided through social welfare programs funded by the government.

4. Critical illness or Dread disease insurance

Critical illness insurance is an insurance product, where the insurer is contracted to typically make a lump sum cash payment if the policyholder is diagnosed with one of the critical illnesses listed in the. The policy may also be structured to pay out regular income and the payout may also be on the policyholder undergoing a surgical procedure, for example, having a heart bypass operation.

Reinsurance

Reinsurance is that is purchased by an (*insurer*) from a *reinsurer* as a means of, to transfer from the *insurer* to the *reinsurer*. The *reinsurer* and the *insurer* enter into a reinsurance agreement which details the conditions upon which the *reinsurer* would pay the *insurer's* losses (in terms of *excess of loss* or *proportional to loss*). The *reinsurer* is paid a reinsurance premium by the *insurer*, and the *insurer* issues thousands of policies.

Topic -4: Rural and social sector obligations

These regulations may be called the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural or Social Sectors) Regulations, 2002. They shall come into force from the date of their publication in the Official Gazette.

Definitions — in these regulations, unless the context otherwise requires -
“Act” means the Insurance Act, 1938 (4 of 1938);

“*Authority”* means the Insurance Regulatory and Development Authority established under the provisions of section 3 of the Insurance Regulatory and Development Authority Act, 1999;

"Rural sector" shall mean any place as per the latest census which meets the following criteria--
a population of less than five thousand; a density of population of less than four hundred per square kilometres; and more than *twenty fiv*e per cent of the male working population is engaged in agricultural pursuits.

Explanation: - *The categories of workers falling under agricultural pursuits are as under:*
(i) Cultivators;
(ii) Agricultural labourers
(iii) Workers in livestock, forestry, fishing, hunting and plantations, orchards and allied activities.

"Social sector" includes unorganised sector, informal sector, economically weak or backward classes and other categories of persons, both in rural and urban areas;

"Unorganised sector" includes self-employed workers such as agricultural labourers, bidi workers, brick kiln workers, carpenters, cobblers, construction workers, fishermen, hamals, handicraft artisans, handloom and khadi workers, lady tailors, leather and tannery workers, papad makers, power loom workers, physically handicapped self-employed persons, primary milk producers, rickshaw pullers, safai karmacharis, salt growers, Seri culture workers, sugarcane cutters, tendu leaf collectors, toddy tapers, vegetable vendors, washerwomen, working women in hills, or such other categories of persons., "Economically vulnerable or backward classes" mean persons who live below the poverty line; "other categories of persons" includes persons with disability as defined in the Persons with Disabilities (Equal Opportunities, Protection of Rights, and Full Participation) Act, 1995 and who may not be gainfully employed; and also includes guardians who need insurance to protect spastic persons or persons with disability;

"*informal sector" includes small scale, self-employed workers typically at a low level of organisation and technology, with the primary objective of generating employment and income, with heterogeneous activities like retail trade, transport, repair and maintenance, construction, personal and domestic services and manufacturing, with the work mostly labour intensive, having often unwritten and informal employer-employee relationship;*

All words and expressions used herein and not defined herein but defined in the Insurance Act, 1938 (4 of 1938), or in the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), shall have the meanings respectively assigned to them in those Acts.

Obligations.--- Every insurer, who begins to carry on insurance business after the commencement of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), shall, for the purposes of sections 32B and 32C of the Act, ensure that he undertakes the following obligations, during the first five financial years, pertaining to the persons in---

(a) Rural sector:
(i) In respect of *a life insurer*, --
- ⇨ *seven* per cent in the first financial year;
- ⇨ nine per cent in the second financial year;
- ⇨ *Twelve* per cent in the third financial year;
- ⇨ *Fourteen* per cent in the fourth financial year;
- ⇨ *Sixteen* per cent in the fifth year; of total policies written direct in that year;

(ii) In respect of *a general insurer*,--
- (I) two per cent in the first financial year;
- (II) three per cent in the second financial year;
- (III) five per cent there after, of total gross premium income written direct in that year.

(b) Social sector, in respect of all insurers, --
- ⇨ five thousand lives in the first financial year;
- ⇨ seven thousand five hundred lives in the second financial year;

- ten thousand lives in the third financial year;
- fifteen thousand lives in the fourth financial year;
- twenty thousand lives in the fifth year;

- Provided that in the first financial year, where the period of operation is less than twelve months, proportionate percentage or number of lives, as the case may be, shall be undertaken.

- Provided further that, in case of a general insurer, the obligations specified shall include insurance for crops.

- Provided further that the Authority may normally, once in every five years, prescribe or revise the obligations as specified in this Regulation.

Obligations of existing insurers: (1) The obligations of existing insurers as on the date of commencement of IRDA Act shall be decided by the Authority after consultation with them and the quantum of insurance business to be done shall not be less than what has been recorded by them for the accounting year ended 31st March, 2002. (2) The Authority shall review such quantum of insurance business periodically and give directions to the insurers for achieving the specified targets.

Topic -5: Policy conditions

This section will guide you through the various intricacies of a life insurance contract and the facts that you must know to make the best out of your life insurance policy. Please read our guidelines immediately.

Payment of Premiums: A grace period of one month but not less than 30 days is allowed where the mode of payment is yearly, half-yearly or quarterly and 15 days for monthly payments. If death occurs within this period, the life assured is covered for full sum assured.

Non-forfeiture regulations: If the policy has run for at least 3 full years and subsequent premiums have not been paid the policy shall not be void but the sum assured will be reduced to a sum which will bear the same ratio as to the number of premiums paid bear to the total number of premiums payable. The concessions regarding claim in the above case is explained in the appropriate section.

Forfeiture in certain events: In case of untrue or incorrect statement contained in the proposal, personal statement, declaration and connected documents or any material information with held, subject to the provision of Section 45 of the Insurance Act 1938, wherever applicable, the policy shall be declared void and all claims to any benefits in virtue thereof shall cease.

Suicide: The policy shall be void, if the Life Assured commits suicide (whether sane or insane at the time) at any time or after the date on which the risk under the policy has commenced but before the expiry of one year from the date of commencement of the policy.
Guaranteed Surrender Value: After payment of premiums for at least three years, the Surrender Value allowed under the policy is equal to 30% of the total premiums paid excluding premiums for the 1st year and all extra premiums.

Salary Saving Scheme: The rate of installment premium shown in the schedule of the policy will remain constant as long as the employee continues with the employer given in the proposal. On leaving the employment of said employer the policyholder should intimate the Corporation. In case of the Salary Saving Scheme being withdrawn by the said employer, the Corporation will intimate the same to the policyholder. Thereafter the 5% rebate given under Salary Saving Scheme will be withdrawn.

Alterations: After the policy is issued, the policyholder in a number of cases finds the terms not suitable to him and desires to change them. LIC allows certain types of alterations during the lifetime of the policy. However, no alteration is permitted within one year of the commencement of the policy with some exceptions. The following alterations are allowed.

- ⇨ Alteration in class or term.
- ⇨ Reduction in the Sum Assured
- ⇨ Alteration in the mode of payment of premiums
- ⇨ Removal of an extra premium
- ⇨ Alteration from without profit plan to with profit plan
- ⇨ Alternation in name
- ⇨ Correction in policies
- ⇨ Settlement option of payment of sum assured by installments
- ⇨ Grant of accident benefit
- ⇨ Grant of premium waiver benefit under CDA policies
- ⇨ Alteration in currency and place of payment of policy monies

A fee for the change or alteration in the policy is charged by the Corporation called quotation fee and no additional fee is charged for giving effect to the alteration.

Duplicate Policy: A duplicate policy confers on its owner the same rights and privileges as the original policy. The following are the requirements for issuing a duplicate policy:

1. Insertion of an advertisement at the policyholder's cost in one English daily newspaper having wide circulation in the State where the loss is reported to have occurred. A copy of the Newspaper in which the advertisement appeared should be sent to the servicing office one month after its appearance. If no objection has been lodged with LIC regarding the policy in question, a duplicate policy will be issued after complying further requirements, i.e., Indemnity Bond and payment of charges for preparing duplicate policy and stamp fee.

2. However, the requirement of advertisement and Indemnity Bond may be dispensed with or modified in certain circumstances as given below:

- ⇨ loss of policy by theft
- ⇨ destruction of policy by fire
- ⇨ loss of policy while in custody of an office of government
- ⇨ mutilated or damaged policy
- ⇨ policy in torn and a part of it is missing
- ⇨ policy partially destroyed by white ants

Age Proof accepted by LIC:

The Proofs of age, which are generally acceptable to the Corporation, are as under:

- ⇨ Certified extract from Municipal or other records made at the time of birth.
- ⇨ Certificate of Baptism or certified extract from family Bible if it contains age or date of birth.
- ⇨ Certified extract from School or College if age or date of birth is stated therein.
- ⇨ Certified extract from Service Register in case of Govt. employees and employees of Quasi-Govt. institutions including Public Limited Companies and Pass port issued by the Pass port Authorities in India.

Alternative Age Proofs which are accepted:

- ⇨ Marriage certificate in the case of Roman Catholics issued by Roman Catholic Church.
- ⇨ Certified extracts from the Service Registers of Commercial Institutions or Industrial Undertakings provided it is specifically mentioned in such extracts that conclusive evidence of age was produced at the time of recruitment of the employee.
- ⇨ Certificate of Birth
- ⇨ Identity Cards issued by Defence Department.
- ⇨ A true copy of the University Certificate or of Matriculation/Higher Secondary Education, S.S.L. Certificate issued by a Board set up by a State/Central Government.
- ⇨ Non- standard age proof like Horoscope, Service Record where age is not verified at the time of entry, E.S.I.S. Card, Marriage Certificate in case of Muslim Proposer, Elder's Declaration, Self-declaration and Certificate by Village Panchayats are accepted subject to certain rules.

Nomination: The nominee is statutorily recognized as a payee who can give a valid discharge to the Corporation for the payment of policy monies.

Nomination will be incorporated in the text of the policy at the time of its issue. After the policy is prepared and issued and if no Nomination has been incorporated the assured can ordinarily affect the nomination only by an endorsement on the policy itself. A nomination made in this manner is required to be notified to the Corporation and registered by it in its records. A nomination is not required to be stamped. Any change or cancellation of nomination should be given in writing only by the Life Assured.

Nomination under Joint Life Policy can only be a joint nomination. Nomination in favour of a stranger cannot be made as there is no insurable interest and moral hazard may be involved. Nomination in favour of wife and children as a class is not valid. Specific names of the existing wife and children should be mentioned. Where nomination is made in favour of successive nominees, i.e., nominee “A” failing him to nominee “B” failing whom nominee “C”, the nomination in favour of one individual in the order mentioned will be considered. Where the nominee is a minor, an appointee has to be appointed to receive the monies in the event of the assureds death during the minority of the nominee. No nomination can be made under a policy financed from HUF funds.

In the case of first endorsement of nomination the date of registration of nomination will be the date of receipt of the policy by the servicing office and in case of any other nomination or cancellation or change thereof, the date of receipt of the policy and/or of notice whichever is later, will be the date of registration.

Health Insurance: (Health and medical insurance)

Health insurance, like other forms of, is a form of by means of which people collectively pool their risk, in this case the risk of incurring medical expenses. The collective is usually publicly owned or else is organized on a non-profit basis for the members of the pool, though in some countries health insurance pools may also be managed by for-profit companies. It is sometimes used more broadly to include insurance covering needs. It may be provided through a government-sponsored program, or from private insurance companies. It may be purchased on a group basis (e.g., by a firm to cover its employees) or purchased by an individual. In each case, the covered groups or individuals pay premiums or taxes to help protect themselves from unexpected healthcare expenses. Similar benefits paying for medical expenses may also be provided through social welfare programs funded by the government.

Critical illness insurance or critical illness cover is an insurance product, where the insurer is contracted to typically make a lump sum cash payment if the policyholder is diagnosed with one of the critical illnesses listed in the. The policy may also be structured to pay out regular income and the payout may also be on the policyholder undergoing a surgical procedure, for example, having a heart bypass operation.

ULIP and Pension plans:

A Unit Linked Insurance Plan (ULIP) is a product offered by insurance companies that unlike a pure insurance policy gives investors the benefits of both insurance and investment under a single integrated plan. The first ULIP was launched in India in 1971 by (UTI). With the opening up the insurance sector to foreign investors in 2001 and the subsequent issue of major guidelines for ULIPs by the (IRDA) in 2005, several insurance companies forayed into the ULIP business leading to an over abundance of ULIP schemes being launched to serve the investment needs of those looking to invest in an investment cum insurance product.

A ULIP is basically a combination of insurance as well as investment. A part of the premium paid is utilized to provide insurance cover to the policy holder while the remaining portion is invested in various equity and debt schemes. The money collected by the insurance provider is utilized to form a pool of fund that is used to invest in various markets instruments (debt and equity) in varying proportions just the way it is done for. Policy holders have the option of selecting the type of funds (debt or equity) or a mix of both based on their investment need and appetite. Just the way it is for mutual funds, ULIP policy holders are also allotted units and each unit has a net asset value (NAV) that is declared on a daily basis. The NAV is the value based on which the net rate of returns on ULIPs are determined. The NAV varies from one ULIP to another based on market conditions and the fund's performance.

ULIP policy holders can make use of features such as top-up facilities, switching between various funds during the tenure of the policy, reduce or increase the level of protection, options to surrender, additional riders to enhance coverage and returns as well as tax benefits.

There are a variety of ULIP plans to choose from based on the investment objectives of the investor, his risk appetite as well as the investment horizon. Some ULIPs play it safe by allocating a larger portion of the invested capital in debt instruments while others purely invest in. Again, all this is totally based on the type of ULIP chosen for investment and the investor preference and risk appetite.

Unlike traditional insurance policies, ULIP schemes have a list of applicable charges that are deducted from the payable premium. The notable ones include policy administration charges, premium allocation charges, fund switching charges, mortality charges, and a policy surrender or withdrawal charge. Some Insurer also charge "Guarantee Charge" as a percentage of Fund Value for built in minimum guarantee under the policy.

Since ULIP returns are directly linked to market performance and the investment risk in investment portfolio is borne entirely by the policy holder, one need to thoroughly understand the risks involved and one's own risk absorption capacity before deciding to invest in ULIPs.

There are several public and private sector insurance providers that either operate solo or have partnered with foreign insurance companies to sell unit linked insurance plans in India. The public insurance providers include LIC of India, SBI Life and Canara while and some of the private insurance providers include Reliance Life, ICICI Prudential, HDFC Life, Bajaj Allianz, Aviva Life Insurance and the excellent Kotak Mahindra Life.

Pension plans: A type of retirement plan, usually tax exempt, wherein an employer makes contributions toward a pool of funds set aside for an employee's future benefit. The pool of funds is then invested on the employee's behalf, allowing the employee to receive benefits upon retirement.
In many ways, a pension plan is a method in which an employee transfers part of his or her current income stream toward retirement income. There are two main types of pension plans: defined-benefit plans and defined-contribution plans. In a defined-benefit plan, the employer guarantees that the employee will receive a definite amount of benefit upon retirement, regardless of the performance of the underlying investment pool. In a defined-contribution plan the employer makes predefined contributions for the employee, but the final amount of benefit received by the employee depends on the investment's performance.

Bancassurance

Bancassurance simply means selling of insurance products by banks. In this arrangement, insurance companies and banks undergo a tie-up, thereby allowing banks to sell the insurance products to its customers. This is a system in which a bank has a corporate agency with one insurance company to sell its products. By selling insurance policies bank earns a revenue stream apart from interest. It is called as fee-based income. This income is purely risk free for the bank since the bank simply plays the role of an intermediary for sourcing business to the insurance company. The Bank Insurance Model ('*BIM*'), also sometimes known as '*Bancassurance'*, is the term used to describe the partnership or relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel in order to sell insurance products.

BIM allows the insurance company to maintain smaller direct sales teams as their products are sold through the bank to bank customers by bank staff.
Bank staff and tellers, rather than an insurance salesperson, become the point of sale/point of contact for the customer. Bank staff are advised and supported by the insurance company through product information, marketing campaigns and sales training.

Both the bank and insurance company share the commission. Insurance policies are processed and administered by the insurance company.

BIM differs from '*Classic'* or Traditional Insurance Model (TIM) in that TIM insurance companies tend to have larger insurance sales teams and generally work with brokers and third party agents such as MAIC.

An additional approach, the Hybrid Insurance Model (HIM), is a mix between BIM and TIM. HIM insurance companies may have a sales force, may use brokers and agents and may have a partnership with a bank.

The motives behind Bancassurance

For a Bank are:

- product diversification
- generating additional income

For Insurance Company are:

- Increasing their market penetration
- Increasing premium turnover
- Reducing initial costs of selling
- Making use of wide network of banks for selling their products.

For a Customer:

- Product at a reduced price
- Product of high quality
- Product at a single point/doorstep.

Some challenges/Problems

1. The Rules of IRDA requires a mandatory 4 weeks training for selling insurance products which the bank employees find it difficult to undergo.
2. Most of the bank branches particularly in rural areas are not fully computerized and there are problems when work of insurance is handled manually.
3. There is a cultural conflict between the products of banks and insurance. While the bank products are “demand” products and insurance products are “push” products. The selling of insurance products, cause lot of pressure for the person selling/bank employee.
4. At times performance recognition becomes problem as to whom the commission on selling insurance product in a bank is to be given.

In spite of these problems, insurance companies are collaborating with banks for selling their products through banks and generating additional income.

Money Market

INTRODUCTION:

Money market is a market dealing with financial assets and securities which have a maturity period of up to one year. In other words, it is a market for purely short-term funds.

It does not deal actually in cash or money but deal with near money like trade bills, promissory notes and Government papers.

Here the instruments are converted into cash readily without any loss and carry low transaction cost.

The transaction between borrowers and middlemen takes place through telephone, telegraph, mails and agents.

No personal contact or presence of two parties is essential for negotiation of money market.

In other words we can say money market purely deal with short term funds.

It meets the short-term requirements of borrowers and provides liquidity of cash to lenders.

Definitions: The RBI Defines the money market as " a market for short term financial assets that are close substitutes for money facilitates the exchange of money for new financial claims in the primary market as also for financial claims, already issued, in the secondary market"

According to Geoffrey Crowther, "the money market is the collector name given to the various firms and institution that deal in the various grades of near money"

Types of money Market:

The money Market may be subdivided into following.

- Call Money Market
- Commercial bill Market
- Treasury bill market
- Short-Term Loan Market

Call money market : The call money market is a market for extremely short-term loans say 1day to 14 days. So, it is highly liquid.

The loans are repayable on demand at the option of either the lender or the borrower.

The special feature of this market is that the interest rates varies from day -to day -and even from hour- to – hour and from center-to-center.

Commercial Bill Market: It is a market for the bills of exchange arising out of genuine trade transaction. In case of credit sales the seller may draw bills of exchange on the buyer. The buyer accepts such a bill promising to pay at a later date the amount specified on the bills,

The seller need not wait until the due date of the bills, instead he can get immediate payment by the discounting of bill .

The commercial bank plays a vital role in this market.

Treasury bill Market: It is a market for treasury bills which have short-term maturity.

It is a promissory note or a financial bill issued by government. It is highly liquid because its payment is guaranteed by Govt.

It is an important instrument for short-term borrowings of the government.

There are two types of treasury bills.

- Ordinary or regular treasury bill
- Adhoc treasury bill

Regular treasury bill : these are issued to the public, banks and other financial institution with a view to raising resources for the central government to meet its short-term financial needs.

Adhoc treasury bill ; These are issued in favor of RBI only, they are not sold through tenders or auction. They can be published by RBI only.

Adhoc are not marketable in India but can be sold to the RBI. These bills have a maturity of 91days or 182 days or 364 days only.

Short term loans market:

It is a market where short-term loans are given to the corporate customers for meeting their working capital requirements.

Commercial banks plays a vital role in this market. It provides short term loans in the form of cash –credit and over draft.

Overdraft facility is given mainly to the business people where as cash credit facilities are given to the industrialists.

Overdraft is purely a temporary accommodation and it is given in current account itself.

But cash credit is a period of one year and it is sanctioned in a separate account.

Features : The following are general features of money market.

a. It is a market purely for short-term funds.
b. It deals with financial assets which have a maturity period up-to one year only.
c. It deals with the assets which can be converted into cash readily without loss and with minimum transactions cost.
d. Generally transactions are takes place through phone

e. Transaction has to be conducted without the help of brokers.
f. It comprises of several sub markets e.g call money market. Acceptance market., bill market and so on.
g. Commercial banks generally play a domination role in this market.

Objectives: The following are the important objective of money market.

a. To provide a parking place to employ short-term surplus funds.
b. To provide room for overcoming short-term deficits.
c. To enable the central bank to influence and regulate liquidity in the economy through its intervention in this market.
d. To provide a reasonable access to users of short-term funds to meet their requirements quickly, adequately and reasonable costs.

MONEY MARKET INSTRUMENTS:

Money market provides the market for short-term financial instruments. The returns of money market instruments are low but they are the safest investments. Money market is an essential part of the economy. It plays a major role in the development of the economy. If the money market is not well developed, the countries face difficulty in pooling funds to finance private enterprise. The RBI introduced financial sector reforms to make money market broad-based and integrated. The important money market instruments are:

1. Call/Notice money:- The call/notice money is the money borrowed or lent on demand for a short period. The money borrowed or lent for a day is known as call (overnight) money. Holidays and Sunday are excluded for this purpose. It is money that is borrowed on a day and repaid on the next working day. The money borrowed or lent for more than a day and up to 14 working days is known notice money. Collateral security is not required to cover these transactions. The participants of call/notice money market are banks, development finance institutions and insurance companies. Banks can operate as a borrower and lender in the market. The non-banks institutions are given specific permission to operate in call-notice money market as lenders only.
2. Treasury bills: - Treasury bills (T-Bills) are the money market instruments that are used to finance the short-term requirements of the Government of India. The maturity of T-bills is one year. As T-bills are highly liquid in nature and can be sold at any time, investors prefer to hold them instead of holding cash. The difference between the maturity value and issue price is the return to the investor. T-bills play a key role in the cash management of the government. T-bills are risk-free instruments and their yields at various maturities serve as bench mark and help in pricing different floating rates instruments in the market.
3. Commercial bills: - Commercial bill is a short-term, self-liquidating, negotiable, low risk instrument. Bills of exchange that are drawn by the seller (drawer) on the buyer (Drawee) for the value of the goods delivered by him are called trade bills. When trade bills are accepted by commercial banks it is called commercial bills. If the seller is need of funds during the currency of the bill, he can approach the bank for discounting the bill. Discounting commercial bills at negotiated discount rate is a method used by banks for providing credit to customers.
4. Money market mutual funds:- Money market mutual fund is a channel through which investors can earn market related yield from investment in money market instruments. Mutual fund is a fund managed by an investment company that collects money from the shareholders and invests in assets. Money market mutual fund is a mutual fund which invests only in money markets. These funds invest in short term debt obligations such as treasury bills and commercial institutions to store money that is not invested.
5. Commercial paper:- Commercial paper investments are unsecured promissory notes issued by corporations. Promissory note is a document signed by a borrower promising to repay a loan under an agreement. Companies issue commercial paper (CP) to finance seasonal cash flow and working capital needs at lower rates. CP is issued in one, two and three month terms. It is highly liquid and can be sold at any time. Investors buy CP because this investment provides the highest return compared to other short-term alternatives such as T-bills. Investment in CP is secure because companies issuing the notes are large.

6. Inter Bank Participation Certificates (IBPCs) :- The interbank participation certificates are the interbank money market instruments used by commercial banks to park their surplus funds. These IBPCs are of two types:
    a. With risk sharing IBPCs: These certificates are issued for 91 to 180 days and interest is determined on these PCs between the issuing and participating bank freely.
    b. Without risk sharing PCs: these IBPCs are money market instruments not exceeding 90 days. The interest on these PCs is determined by the two contracting banks.
7. Certificate of Deposits (CDs): As per the Reserve Bank of India, Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory note against funds deposited at a bank or other eligible financial institutions for a specified time period.

    CDs are marketable receipts in bearer or registered form of funds deposited in a bank or other eligible financial institutions for a specified period at a specified rate of interest. They are different from the fixed deposits in the sense that they are freely transferable, can be sold to someone else and can be traded on the secondary market. They are liquid and risk less in terms of default of payment of interest and principal. As per RBI guidelines, at present the minimum amount of a CD should be Rs. 1 lakh and in multiples of Rs 1 lakh thereafter. The maturity period of certificate of deposit, at present should not be less than 7 days and not more than one year from the date of issue, in case of CD issued by a bank. Although, the financial institutions can issue CDs for a period not less than one year and not exceeding three years from the date of the issue.

Capital Market

Introduction: The capital market is a place where the medium term and long term needs of business and other undertakings met by financial institutions which supply medium –term resources to borrowers.

These institutions may be classified into investing activities and development banks on the basis of nature of their activities.

Functions/ Importance of capital market:

Capital market plays an important role in mobilizing resources and diverting them in productive channels. In this way it facilitates and promotes the process of economic growth in the country.

Various functions of capital market are as follows.

(a) **Link between savers and investors:** The capital market functions as a link between savers and investors. It plays an important role in mobilizing the saving and directing them in productive investment.

(b) **Encourages the saving:** with the development of capital market, the banking and non-banking institutions provides facilities which encourages people to save more.
In the developed countries in the absence of capital market, there are very little savings and those who have save often invest their saving in unproductive and wasteful directions.

(c) **Encouragement to investment:** The capital market facilitates lending to the businessmen and the government thus encourages investment.
It provides facilitates through banks and non- banking financial institutions.
Various financial assets e.g. shares, securities and bonds etc. induce savers to lend to the government invest n industry.
With the development of financial institutions, capitals become more mobile, interest fall and invest increases.

(d) **Promoters Economic Growth:** The capital Market not only refers the general condition of the economy, but also smoothens and accelerates the process of economic growth.

Various institutions of the capital market, like non-banking financial intermediaries, allocate the resources rationally in accordance with the development need of the country.

The proper allocation of resources results in the expansion of trade and industry in both public and private sector. Thus promoting balanced economic growth in the country.

(e) Stability in securities prices : The capital market trends to stabilize the values of stock and securities and reduce the fluctuation in the prices to the minimum. The process of stabilization is facilitated by providing capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

(f) Benefits to investors: The credit market help the investors ,i.e those who have funds to invest in long –term financial assets, in many ways-

a) It brings together the buyers and sellers of securities and thus ensures the marketability of investments.
b) By advertising security prices, the stock exchange enables the investors to keep track of their investments and channelize them intro most profitable lines.
c) It safeguards the interest of the investors by compensating them from the stock exchange compensating fund in the event of fraud and default.

INSTRUMENT OF CAPITAL MARKET:

It 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. Capital market may be further divided into three groups.

a. Industrial security market.
b. Government security market.
c. Long-term security market.

a. Industrial security market: As the very name implies it is the market for industrial securities namely: i. Ordinary or Equity share, ii. Preference Share, iii. Debenture/ Bonds
It is the market where industrial concerns raise their capital or debt by issuing appropriate instruments. It can be further sub divided in to two. They are: 1. Primary market or new issue market. 2. Secondary or stock exchange market.

PRIMARY MARKET: It is a market for new issue or new financial claims. So, it is also called as new issue market.

The primary market deals with those securities which are issued to the public for the first time.

In the primary market, borrowers exchange new financial securities for long term funds. Thus, primary market facilitates capital formation.

There are three ways in which a company may raise capital in a primary market. They are i. Public issue, ii. Right Issue, iii. Private placement.

The common method of raising capital by new companies is through sale of securities to public. It is called public issue.

When an existing company wants to raise additional capital, securities are first offered to the existing shareholders. It is called right issue.

Private placement is a way of selling securities privately to a small group of investors.

SECONDARY MARKET: Secondary market is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally such securities are quoted in the stock exchange and it provides a continuous and regular market for buying and selling securities. This market consists of all stock exchanges recognized by government of India. These stock exchanges in India are regulated under the Securities Contracts (Regulation) Act. 1956.

b) GOVERNMENT SECURITIES MARKET: It is otherwise called as Gilt-edged securities market. It is a market where government securities are traded. In India there are many kinds of govt. securities namely i. Short term, ii. Long term

Long term securities are traded in GSM While short-term securities are traded in the money market.

Securities are issued by central government, state government, semi-govt. authorities like corporations, port trusts etc.

Improvement trusts, state electricity boards, all India and state level institutions and public sector enterprises are dealt in the market.

Govt. securities are issued in denominations of Rs. 100.

Interest is payable half-yearly and they carry tax exemption.

The role of the brokers in marketing these securities is practically limited and major participant in this market is the commercial banks because they hold a very substantial portion of these securities satisfying their SLR requirements.

C. LONG-TERM LOAN MARKETS: Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customer. This market further classified into three categories: i. Term loan market, ii. Mortgage market, iii. Financial guarantees market.

i) Term Loan Market: (Corporate Customer): In India many industrial financing institutions have been created by the Govt. both at national and regional levels to supply long-term and medium term loan to corporate customer directly as well as indirectly.

The developmental banks dominate the industrial finance in India. Institutions like IDBI, ICICI, IFCI and other financial institutions come under this category. These institutions meet the growing and varied long term financial requirements of industry by supplying long term loans. They also help in identifying investment opportunity encourage a new entrepreneur and support modernization efforts.

ii) Mortgage Market (Individual Customer): This market refers to those centers which supply mortgages loan mainly to individual customers. A mortgage is a loan which is given against the security of immovable property like real estate. The transfer of interest in a specific immovable property to secure a loan is called mortgage loan. It may be equitable mortgage or legal one. It may be first charge or second charge. In the first charge the mortgager transfer his interest in the specific property to the mortgagee as security. The mortgage market may have the primary market as well as secondary market. The secondary market has sale and resale of existing mortgage at prevailing prices where as the primary market consists of original extension of credit.

iii) Financial guarantees market: A guarantee market is a centre where finance is provided against the guarantee of a reputed person in the financial circle. Guarantee is a contract to discharge the liability of a third party in case of his default. Hence, the guarantor must know the borrower and the lender and he must have the means to discharge his liabilities. Though there are many types of guarantees, the common forms are performance guarantee and financial guarantee.

Regulations Governing Primary capital markets in India: The overall responsibility of development, regulation and supervision of the stock market rests with the (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach. Any company making a public issue or a listed company making a rights issue of value of more than Rs 50 lakh is required to file a draft offer document with SEBI for its observations. The company can proceed further on the issue only after getting observations from SEBI. The validity period of SEBI's observation letter is three months only i.e. the company has to open its issue within three months period.

Public issue in foreign capital markets: Indian companies are permitted to raise foreign currency resources through two main sources: a) issue of foreign currency convertible bonds more commonly known as 'Euro' issues and b) issue of ordinary shares through depository receipts namely 'Global Depository Receipts (GDRs)/American Depository Receipts (ADRs)' to foreign investors i.e. to the institutional investors or individual investors.

The Secondary Market/ Stock Exchanges:

The market where existing securities are traded is referred to as the secondary market or stock market. In a stock market, purchases and sales of securities whether of Government or Semi-Government bodies or other public bodies and also shares and debentures issued by joint stock companies are affected. The securities of government are traded in the stock market as a separate component, called guilt edged market. Government securities are traded outside the trading wing in the form of over the counter sales or purchases. Another component of the stock market deals with trading in shares and debentures of limited companies.

Control over Secondary Market

For the effective functioning of secondary market, proper control must be exercised. At present, control is exercised through the following three important processes:

a) Recognition of Stock Exchanges
b) Listing of Securities
c) Registration of Brokers.

a) Recognition of Stock Exchanges: Stock exchanges are the important ingredient of the capital market. They are the citadel of capital and fortress of finance. They are the theatres of trading in securities and as such they assist and control the buying and selling of securities. Thus, according to Husband and Dockeray "securities or stock exchanges are privately organized markets which are used to facilities trading in securities." However, at present stock exchanges need not necessarily be privately organized once.

As per the securities Contacts Regulation Act, 1956 a stock exchange has been defined as follows: "It is an association, organization or body of individuals whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities." In brief, stocks exchanges constitute a market where securities issued by the central and state governments, public bodies and joint stock companies are traded.

b. Listing of securities: Listing of securities means that the securities are admitted for trading on a recognized stock exchange. Transactions in the securities of any company cannot be conducted on stock exchanges unless they are listed by them. Hence, listing is the very basis on stock exchange operations. It is the green signal given to selected securities to get the trading privileges of the stock exchange concerned. Securities become eligible for trading only through listing.

Listing is compulsory for those companies which intend to offer shares/debentures to the public for subscription by means of issuing a prospectus. Moreover, the SEBI insists on listing for granting permission to a new issue by a public limited company. Again, financial institutions do insist on listing for underwriting new issues. Thus, listing becomes an unavoidable one today.

The companies which have got their shares/debentures listed in one or more recognized stock exchanges must submit themselves to the various regulatory measures of the stock exchange concerned as well as the SEBI. They must maintain necessary books; documents etc. and disclose any information which the stock exchange may call for.

C. Registration of Brokers: A broker is none other than a commission agent who transacts business in securities on behalf of his clients who are non-members of a stock exchange. Thus, a non-member can purchase and sell securities only through a broker who is the member of the stock exchange. To deal in securities on recognized stock exchanges, the broker should register his name as a broker with the SEBI. A stock broker must possess the following qualification to register as a broker:

(a) He must be an Indian citizen with 21 years of age.

(b) He should neither be a bankrupt nor compounded with creditors.

(c) He should not have been convicted for any offence, fraud etc.

(d) He should not have engaged in any other business other than that of a broker in securities.

(e) He should not be a defaulter of any stock exchange.

(f) He should have completed 12th std examinations.

<u>Functions of stock exchange:</u> Stock market performs pivotal position in the financial system. It performs several economic functions and renders invaluable service to the investors, and to the economy as a whole

1. **Liquidity and marketability of securities:** Stock exchanges provide liquidity to securities since securities can be converted to cash at any time according to the discretion of the investor by selling them at the listed prices. They facilitate buying and selling of securities at listed prices by providing continuous marketability to the investors in respect of securities they hold or intend to hold. Thus, they create a ready outlet for dealing in securities
2. **Safety of funds:** Stock exchanges ensure safety of funds invested because they have to function under strict rules and regulations and bye-laws are meant to ensure safety of investible funds. Over- trading, illegitimate speculation etc. are prevented through carefully designed set of rules. This would strengthen the investor's confidence and promote larger investment.
3. **Supply of long term funds:** The securities traded in the stock market are negotiable and transferable in character and as such they can be transferred with minimum of formalities from one hand to another. So, when a security is transacted, one investor is substituted by another, but company is assured of long term availability of funds
4. **Flow of capital to profitable ventures:** The profitable and popularity of companies are reflected in stock prices. The prices quoted indicate the relative profitability and performance of companies. Funds tend to be attracted towards securities of profitable companies and this facilitates the flow of capital into profitable channels.
5. **Motivation for improved performance:** The performance of a company is reflected on the prices quoted in the stock market. These prices are more visible in the eyes of the public. Stock market provides room for this price quotation for these securities listed by it. This public exposure makes a company conscious of its status in the market and it acts as a motivation to improve its performance further
6. **Promotion of investment:** Stock exchanges mobilize the savings of the public and promote investment through capital formation. But for these Stock exchanges, surplus funds available with individuals and institutions would not have gone for productive and remunerative ventures
7. **Reflection of business cycle:** The changing business conditions in the economy are immediately reflected on the stock exchanges. Booms and depressions can be identified through the dealings on the Stock exchanges and suitable monetary and fiscal policies can be taken by the government. Thus a Stock market portrays the prevailing economic situation instantly to all concerned so that suitable actions can be taken.
8. **Marketing of new issues:** If the new issues are listed, they are readily acceptable to the public, since listing presupposes their evaluation by concerned stock exchange authorities. Costs of underwriting such issues would be less. Public response to such new issues would be relatively high. Thus, a stock market helps in the marketing of new issues also
9. **Miscellaneous services:** Stock exchange supplies securities of different kinds with different maturities and yields. It enables the investors to diversify their risks by a wider portfolio of investment. It also inculcates saving habits among the community and paves the way for capital formation. It guides the investors in choosing securities by supplying the daily quotation of listed securities and by disclosing the trends of dealings on the Stock

exchange. It enables companies and the government to raise resources by providing a ready market for their securities.

FEATURES OF SECONDARY MARKET: The market where securities are traded after they are initially offered in the primary market. Most trading is done in the secondary market.

- In Secondary market share are traded between two investors.
- In secondary market there is no issuing of the fresh securities but trading of the already issued securities
- In secondary market both buying and selling can take place
- It has a special and fixed place known as stock exchange. However, it must be noted that it is not essential that all the buying and selling of securities will be done only through stock exchange. Two individuals can buy or sell them manually. This will also be called a transaction of the secondary market. Generally, most of the transactions are made through the medium of stock exchange.

Example are the New York Stock Exchange (NYSE), Bombay Stock Exchange (BSE),National Stock Exchange NSE, bond markets, over-the-counter markets, residential mortgage loans, governmental guaranteed loans etc.

- The prices of securities in secondary market are determined by demand and supply.
- Only investors do the trading among themselves in secondary market.
- The trading of securities does not take place first. A security can be traded in the secondary market only if issued in the primary market.
- Secondary market creates liquidity, hence, indirectly promotes capital formation.
- It creates liquidity in securities. Liquidity means immediate conversion of securities into cash. This job is performed by the secondary market.
- Secondary market comes after primary market. New securities are first sold in the primary market and thereafter it is the turn of the secondary market.

Topic -12: Trading Mechanisms:

Trading Process

- **Selection of a Broker**
- **Placing an Order**
- **Making a Contract**
- **Contract Note**
- **Settlement**

Trading at Indian stock exchanges takes place through an open electronic, in which order matching is done by the trading computer. There are no and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain unknown. The advantage of an order driven market is that it brings more transparency, by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed.

All orders in the trading system need to be placed through brokers, many of which provide online trading facility to retail customers. can also take advantage of the (DMA) option, in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system.

Dematerialization of shares: In order to mitigate the risks associated with share trading in paper format, concept was introduced in Indian Financial Market. Dematerialisation or in short is the process through which an investor's physical share certificate gets converted to electronic format which is maintained in an account with the India adopted the demat System successfully and there are plans to facilitate trading of almost all financial assets in demat format in future.

What is it?

Dematerialisation is the process of converting physical shares into electronic format. An investor who wants to dematerialize his shares needs to open a demat account with Depository Participant. Investor surrenders his physical shares and in turn gets electronic shares in his demat account.

Storage of Dematerialized Shares – Depository

Depository is the body which is responsible for storing and maintaining investor's securities in demat or electronic format. In India there are two depositories i.e. NSDL and CDSL.

Who is a Depository Participant?

Depository Participant (DP) is the market intermediary through which investors can avail the depository services. Depository Participant provides financial services and includes organizations like banks, brokers, custodians and financial institutions.

Advantages of Demat

Dealing in demat format is beneficial for investors, brokers and companies alike. It reduces the risk of holding shares in physical format from investor's perspective. It's beneficial for brokers as it reduces the risk of delayed settlement and enhances profit because of increased participation.

From share issuing company's perspective, issuance in demat format reduces the cost of new issue as papers are not involved. Efficiency and timeliness of the issue is also maintained while companies deal in demat format.

There are a lot of other benefits, but let's focus on benefits with respect to common investor and the same are listed below.

- Demat format reduces the risk of bad deliveries
- Time and money is saved as you are not dealing in paper now. You need not go to the notary, broker for taking delivery or submitting the share certificate
- Liquidity is very high in case of demat format as whole process in automated.
- All the benefits of corporate action like bonus, stock split, rights etc are managed through the depository leading to elimination of transit losses
- Interest on loan against demat shares are less as compared to physical shares
- Investors save stamp duty while transferring shares in demat format.
- One needs to pay less brokerage in case of demat shares

Demat Conversion

Most of the trading in shares are done in demat format now a day, but there are few investors who still hold shares in paper format. You cannot deal in paper shares now, so you need to dematerialize them first. In order to dematerialize physical/paper shares, investors need to fill Demat Request

Form (DRF), and submit the same along with physical shares. DRF is available with the DP and you simply need to raise a request for demat conversion with the DP. Their representative will come and get the DRF form signed. So the complete process of dematerialization involves:

1. Investor surrenders the physical certificates for dematerialization to the DP along with DRF.
2. DP updates the account of the investor and shares are allocated in investor demat holding.

Settlement cycle: Equity spot markets follow a T+2 This means that any trade taking place on Monday gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 am and 3:30 pm, Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk, by serving as a central counterparty.

Clearing corporations: An organization associated with an exchange to handle the confirmation, settlement and delivery of transactions, fulfilling the main obligation of ensuring transactions are made in a prompt and efficient manner. They are also referred to as "clearing firms" or "clearing houses". In order to make certain that transactions run smoothly, clearing corporations become the buyer to every seller and the seller to every buyer. In other words, they take the offsetting position with a client in every transaction.

Price bands: The prospectus may contain either the floor price for the securities or a price band within which the investors can bid. The spread between the floor and the cap of the price band shall not be more than 20%. In other words, it means that the cap should not be more than 120% of the floor price. The price band can have a revision and such a revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing a press release and also indicating the change on the relevant website and the terminals of the trading members participating in the book building process. In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten days. It may be understood that the regulatory mechanism does not play a role in setting the price for issues. It is up to the company to decide on the price or the price band, in consultation with Merchant Bankers.

Risk management: The risk management system in case of Indian stock exchanges is based on two pillars. While margins calculated on open positions and collateral deposited against it forms the first line of defence, deposit based capital (base minimum capital, liquid net worth) given by trading member (TM)/clearing member (CM) becomes the second line of defence against failure of any market participant.

As against net positions serving as the basis for levying margins on brokers for positions taken by them and their clients as implemented in other jurisdictions, in India VaR (Value at Risk) based margins are imposed at a client level i.e. net for a client and gross across all clients for the broker, thereby ignoring any netting-off that may occur between client-client and client proprietary positions. VaR based margins are updated 5 times per day to keep the margin requirements in synchronization with the current level of market volatility. In addition to VaR based initial margins there are additional requirements specified, as a second level of defence, in the form of an exposure margin/extreme loss margins which provides extra cushion in case of tail risk events and finally mark-to-market losses are collected and paid in cash on a daily basis.

Indian stock exchanges have a deposit based capital requirement over and above entry level and continuing net worth criteria for market participants undertaking the trading/clearing activity. Such net worth requirements vary based on the nature of the business activity, trading or clearing or both, of the participant. Further in addition to the minimum capital requirements, Stock Exchanges/Clearing Corporations have been empowered to collect additional deposits in order to satisfy itself on the parameter of credit risk. This is as against a balance sheet based capital adequacy requirement prevalent in many other jurisdictions.

A sound risk management system is integral to an efficient clearing and settlement system. NSE introduced for the first time in India, risk containment measures that were common internationally but were absent from the Indian securities markets. Risk containment measures include capital adequacy requirements of members, monitoring of member performance and track record, stringent margin requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached, etc.

Trading Rules:

A Stock exchange is a corporation or organization that provides trading facilities for stockbrokers and traders. Instruments traded on stock exchanges include stocks, investment trusts, commodities, options, mutual funds, unit trusts and bonds. Only members can trade on an exchange.

Specialists: A stock specialist is a member of a stock exchange who provides several services. They make a market in stocks by providing the best bid and best ask during trading hours. Specialists also maintain a fair and orderly market.

Floor Brokers: Floor brokers trade on the floor on the major exchanges. Floor brokers buy and sell securities in their own account. Floor brokers are required to take and pass written tests in order to trade. They must abide by exchange rules, and they must be a member of the exchange on which they trade.

IFSS **MODULE-3**

Concept of Mutual funds

Mutual fund is a mechanism of pooling resources by issuing units to investors and investing their funds in securities to get a good return. Out of the return received the mutual fund keeps a margin for its costs and distributes the profits to the investors. These funds have to be invested according to the objectives provided in offer documents. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced.

Features of mutual funds

Mutual fund is a financial institution. It can be compared with an investment company which pools the financial resources of the people and uses the same for investing in different securities to earn a rate of return. It has the following features:

(a) Management: The professional consultants have the specialized knowledge due to expertise and training in evaluating investments. They have superiority in managing the portfolios.

(b) Small Saver: Mutual funds accommodate investors who don't have a lot of money to invest by setting relatively low rupee value for initial purchases, subsequent monthly purchases, or both.

(c) Liquidity: Mutual fund investors can readily redeem their shares at the current NAV plus any fees and charges assessed on redemption at any time. Investments made in units give the advantage of liquidity to the investor. The investor may purchase the units and sell them at any time in an open ended scheme. The small investor does not even have to find any other investor in the stock exchange or wait for the liquidity of his funds. The terms of payment on re-purchase are low.

(d) Diversification: Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Share prices can move up or down. The investor should be aware of these risks while making an investment decision. Even with risks it is expected that the mutual funds are able to perform better than an individual because a careful selection of securities over a diversified portfolio covering large number of companies and industries is made and the portfolio is constantly reviewed_ Spreading investments across a wide range of companies and industry sectors can help to lower risk.

(e) Analysis and Selection of Securities: Mutual funds select a large share of equities in the case of growth schemes. Although this has a greater risk and potential for capital appreciation is higher in growth schemes. Besides growth schemes mutual funds also have incense schemes. When they have income schemes they invest in securities of a guaranteed return_ They- generally select a large share of fixed income securities like debentures and bonds. All growth schemes are closed ended and income schemes are either closed aided or open ended.

(f) Professional Management: Professional money managers research, select, and monitor the performance of the securities the fund purchases. This helps the investor in achieving a higher return than he would gain by investing in individual securities without professional help.

All mutual funds in the public sector, private sector and those promoted by foreign entities are governed by the same set of Regulations by SEBI, which is the controlling authority.

Structure of a mutual fund

The mutual funds have specific objectives for the investor. They have certain representatives called trustees who look after their funds and diversify them into proper portfolio. This diversification is made in the combination of dividend income and capital growth. The diversification pattern involves common stocks, preference shares and bonds. They also diversify according to companies, industries, size of companies and age of companies and have a combination of both risky and non-risky portfolios. Mutual funds are established in a form of a Trust. The Trust consists of Sponsor, Board of Trustees, Asset Management Company (AMC) and a Custodian and a Trust Agreement.

The SEBI Regulation Act of 1996 has defined a mutual fund as one, which is constituted in the form of a Trust under the Indian Trust Act, 1882. The structure of a mutual fund consists of the following:

• **Asset Management Company:** It manages the funds of a mutual fund by diversifying the is investments of a company in different type of securities. The company has to be registered with SEBI and is setup as a trust. It works under the guidelines of SEBI.

• **Sponsor** is a person or a body corporate which establishes a mutual fund. It also appoints its a Board of Trustees to manage the Trust according to the provisions provided by SEBI.

• **Board of Trustees:** This is a position of trust and confidence mainly for the benefit of the he unit holders. The trustees select stock according to the price, quantity of stock and their Of investment policy. They operate upon the fact that the investors have limited knowledge of the environment as well as of the quality of the investments and its management are an superior to the investment in funds by a single naive investor. They are able to draw upon ne the special dividend as well as capital appreciation factors of a particular security. Their specialized knowledge helps them to diversify in those stocks which give the ideal combination of securities.

• **Custodian,** Bankers, Registrar and Transfer Agents are appointed by Trustees to provide the financial services to the mutual funds.

These factors can be summarized in the following manner. The professional consultants have the following superiority in managing the portfolios:

(a) Management.

(b) Liquidity.

(c) Diversification.

(d) Analysis and selection of securities.

(e) Specialized knowledge due to expertise and training in evaluating investments.

Mutual fund schemes

The Mutual Funds operate under the advantages of (a) diversification, (b) quality of management, and (c) liquidity of funds. These companies are of different kinds. But the most important difference between them is that of closed end and open-end mutual funds. The following classification is given of mutual funds:

(a)open Ended: The Unit Trust of India is an open-end mutual fund company. The open-ended fund is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. In such a company the purchase price and sale price change daily because of fluctuations in stock prices. The mutual funds repurchase shares directly from the investing public. The Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices, which are declared on a daily basis. The key feature of open-end schemes is liquidity. The investors should take loads into consideration while making investment as these affect their yields/returns. A Load is a charge or a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is `10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay `10.10 and those who offer their units for repurchase to the mutual fund will get only `9.90 per unit. Efficient funds may give higher returns in spite of loads. Mutual funds cannot increase the load beyond the level which is printed in the offer document. If there is any change in the load it will be applicable only to prospective investments and not to the existing investments. In case mutual funds want to increase loads, they are required to amend their offer documents before approaching new investors.

Sometimes there are no-load funds this means that there is no charge for entry or exit. It means the investors can enter the scheme at NAV and no additional charges are payable on purchase or sale of units.

(b) Closed Ended: The closed end mutual fund is like any other company operating in an industry. Its main objective is to sell shares to the public, through public subscription. It has its own Memorandum of Association and Articles of Association and Prospectus. It is listed on a stock exchange and its stocks and shares are, treated on the stock exchange. Such a company can mate additional issues to the public. They can sell their shares at any value above or below the net asset value of their shares. The net asset value (NAV) of the shares is the total market value of funds, performance minus its liabilities divided by total number of shares' outstanding. The shares of mutual fund companies often sell at a discount because the closed end companies are considered to be highly risky from the investor's point of view. A close-ended fund or scheme has a stipulated maturity period, e.g., 5-7 years. In India, these companies usually belong to part of a group company and use the amount collected by it to put into expansion programmes of the other group companies by giving them this amount as loan. The shares of these companies are very often traded at a great discount. When the discount is very high it is worthwhile for an investor to make investments. In these companies, units are listed in order to provide an exit route to the investors. Some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. According to SEBI regulations there should be at least one exit route for investors.

(c) Income Fund: The aim of income funds is to provide regular and steady income to the investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes because they are not affected with fluctuations that may take place in equity shares. Income Fund has the limitation that it is restricted with certain opportunities. They promise a regular income in the form of dividends but they do not have the advantage of capital appreciation.

(d) Funds: The aim of growth funds is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

(e) Dual Funds: The dual funds company is also closed end. It operates with two different kinds of shares. It has both capital shares as well as income shares. If an investor wishes // to buy stocks in such a company he must specify the kind of stock which he wants to I purchase.'If he purchases stock of capital gains then the return from the company to him will be only in the form of gains and capital. Thus, investors who purchase income shares will receive from the company only dividends and interest, which the company earns. This it will pass on to the investor. Such a company has a dual role and because of these roles it is thus named the dual fund investment company. The investor in such a company thus specifies the kind of interest that he has — capital appreciation or income appreciation. Such companies work well but the quality of management is very important because it is responsible for proper diversification and maintaining the balance of investments. The company has to have a proper combination of diversification into stocks of capital gains as well as stocks of dividend-yield companies.

(f) Fowls: Index Funds are invested by a mutual fund according to a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty). These schemes invest in the securities in the same weight as that of an index. NAVs of such schemes are expected to rise or fall in accordance with the rise or fall in the index, by the same percentage. Information is given through the offer document of the mutual fund scheme. In the Unites States a new type of fund called the index fund is being operated. These funds are based on fact that the costs are made as low as possible. The costs are taken into consideration by calculating beta. This is based on the Random Walk theory and investments are made according to the index fund by bringing down the unsystematic risk by proper diversification and reducing systematic risk through a study of the market factors with the risk and return factors.

(g) Gilt Fund: These funds invest exclusively in government securities. Government z' securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as are the case with income or debt oriented schemes.

(o) Saving Schemes: These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act. It offers tax incentives for investment in specified avenues. For example. Linked Savings Schemes and Pension schemes launched by the mutual funds offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities..

Plans of mutual funds: There are two important investment plans which are strategies provided to an investor for making his investments. These plans are called the systematic investment plan (SIP) and the systematic withdrawal plan (SWP).

1. **Systematic Investment Plan (SIP)**

This is a strategy whereby an investor can decide the amount of money that he can invest every month. This plan is useful for long term investors who have an appetite for risk taking in equity shares. It has the following features:

• Regular Payments: It can be paid in installments every month or an interval of 12 Months.

• Discipline in Investing: The investor becomes disciplined in making continuous deposits every month

• Averaging the Cost: It reduces the average costs per unit and the investor can have the advantage of smoothening fluctuations in the capital market. The security prices change in the. market but the investor takes the units based on the Net Asset Value of a mutual fund. If price is increase the units that he gets will decrease but this will even out in the long nm and the average price will reduce.

• Convenient Payments: It is convenient because the investor can give post dated cheques for making an investment in a particular mutual fund.

2. **Systematic Withdrawal Plan (SWP)**

This plan is useful for withdrawing money from the mutual fund on a regular basis. This can be done either on a fixed basis or withdrawal of appreciated amount.

• Fixed Withdrawal: The plan gives the flexibility to a unit holder to withdraw a fixed amount every month.

• Appreciated Amount Withdrawal: The unit holder may withdraw the appreciated amount on his unit every month or in two or three installments every year.

MUTUAL FUND INVESTMENTVSSTOCKMARKET INVESTMENT

Mutual Fund	Stocks
Passive investing	Active investing
Relies on fund manager skill	Relies on own skill
Entry and exit monitored and managed	Entry & exit based on self-projections
Have options of varied asset classes to invest in - from stocks, to bonds, gold etc	Have a plethora of sectors within the equity market
Have the option to be well-diversified	Funds get concentrated on a few stocks/sectors
Time consuming while selecting the right fund.	Needs to be actively monitored pre and post selecting the stocks to invest in.

VENTURE CAPITAL

Venture capital is a growing business of recent origin in the area industrial financing in India. The various financial institutions set up in Ind to promote industries have done commendable work. However, the institutions do not come up to the benefit of risky ventures when they ai undertaken by new or relatively unknown entrepreneurs. They contend I give debt finance, mostly in the form of term loans to the promoters an their functioning has been more akin to that of commercial banks. The financial institutions have devised schemes such as seed capital scheme, risk capital fund, etc., to help new entrepreneurs. However, to evaluate the projects an extend financial assistance, they follow the criteria such as safety, security liquidity and profitability and not potentiality. The capital market with it conventional financial instruments/schemes does not come much to the benefit or risky venture. New institutions such as mutual funds, leasing and hire purchase companies have been established as another source of finance to industries. These institutions also do not mitigate the problems of new entrepreneurs who undertake risky and innovative ventures.

India is poised for a technological revolution with the emergence of new breed of entrepreneurs with required professional temperament and technical know-how. To make the innovative technology of the entrepreneurs a successful business venture, support in all respects and more particularly in the form of financial assistance is all the more essential. This has necessitated the setting up of venture capital financing division/companies during the later part of eighties.

CONCEPT OF VENTURE CAPITAL

The term 'Venture Capital' is understood in many ways. In a narrow sense, it refers to, investment in new and tried enterprises that are lacking a stable record of growth.

In a broader sense, venture capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specializing in new ideas or new technologies. It is not merely an injection of funds into a new firm; it is a simultaneous input of skill needed to set up the firm, design its marketing strategy and organise and manage it. It is an association with successive stages of firm's development with distinctive types of financing appropriate to each stage of development.

Meaning of venture capital

Venture capital is long-term risk capital to finance high technology projects which involve risk but at the same time has strong potential for growth. Venture capitalists pool their resources including managerial abilities to assist new entrepreneurs in the early years of the project. Once the project reaches the stage of profitability, they sell their equity holdings at a high premium. **Definition of a venture capital company**

A venture capital company is defined as 'a financing institution which joins an entrepreneur as a copromoter in a project and shares the risks and rewards of the enterprise'.

FEATURES OF VENTURE CAPITAL

Some of the features of venture capital financing are as under:

1. Venture capital is usually in the form of an equity participation. It may also take the form of convertible debt or long-term loan.

2. Investment is made only in high risk but high growth potential projects.

3. Venture capital is available only for commercialization of new ideas or new technologies and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development.

4. Venture capitalist joins the entrepreneur as a co promoter in projects and share the risks and rewards of the enterprise.

5. There is continuous involvement in business after making an investment by the investor.

6. Once the venture has reached the full potential, the venture capitalist disinvests his holdings either to the promoters or in the market. The basic objective of investment is not profit but capital appreciation at the time of disinvestment.

7. Venture capital is not just injection of money but also an input needed to set up the firm, design its marketing strategy and organize and manage it.

8. Investment is usually made in small and medium-scale enterprises.

STAGES OF VENTURE CAPITAL

Venture capital may take various forms at different stages of the project. There are four successive stages of development of a project, viz., development of a project idea, implementation of the idea, commercial production and marketing and finally large-scale investment to exploit the economies of scale and achieve stability. Financial institutions and banks usually start financing the project only at the second or third stage but rarely from the first stage. But venture capitalists provide finance even from the first stage of idea formulation. The various stages in the financing of venture capital are described below:

1) Development of an idea — seed finance: In the initial stage, venture capitalists provide seed capital for translating an idea into business proposition. At this stage, investigation is made in depth which normally takes a year or more.

(2) Implementation stage — start-up finance: When the firm is set up to manufacture a product or provide a service, start-up finance is provided by the venture capitalists. The first and second stage capital is used for full scale manufacturing and further business growth.

(3) Fledging stage — additional finance: In the third stage, the firm has made some headway and entered the stage of manufacturing a product but faces teething problems. It may not be able to generate adequate funds and so additional round of financing is provided to develop the marketing infrastructure.

(4) Establishment stage — establishment finance: At this stage, the firm is established in the market and expected to expand at a rapid pace. It needs further financing for expansion and diversification so that it can reap economies of scale and attain stability. At the end of the establishment stage, the firm is listed on the stock exchange and at this point the venture capitalist disinvests their shareholdings through available exit routes.

Before investing in small, new or young hi-tech enterprises, the venture capitalists look for percentage of key success factors of a venture capital project. They prefer projects that address these problems. An idea developed for these success factors has been presented in Table 13.1.

After assessing the viability of projects, the investors decide for what I The stage they should provide venture capital so that it leads to greater capital dev appreciation

IMPORTANCE OF VENTURE CAPITAL

Venture capital is of great practical value to every corporate enterprise in modern times.

I. Advantages to investing public

1. The investing public will be able to reduce risk significantly against unscrupulous management, if the public invest in venture fund who in turn will invest in equity of new business. With their expertise in the field and continuous involvement in the business, they would be able to stop malpractices by management.

2. Investors have no means to vouch for the reasonableness of the claims made by the promoters about profitability of the business. The venture funds equipped with necessary skills will be able to analyze the prospects of the business.

3. The investors do not have any means to ensure that the affairs of the business are conducted prudently. The venture fund having representatives on the Board of Directors of the company would overcome it.

II. Advantages to promoters

1. The entrepreneur for the success of public issue is required to convince the underwriters, brokers and thousands of investors. But to obtain venture capital assistance, he will be required to sell his idea to justify the officials of the venture fund. Venture capital provides a solid capital base for future growth by injecting long-term equity financing.

2. Public issue of equity shares has to be preceeded by a lot of efforts, viz., necessary statutory sanctions, underwriting and broker's arrangement, publicity of issue, etc. The new entrepreneurs find it very difficult to make underwriting arrangements which require a great deal of effort. Venture fund assistance would eliminate those efforts by leaving entrepreneur to concentrate upon bread and butter activities of business.

3. Costs of public issues of equity share often range between 10 per cent to 15 per cent of nominal value of issue of moderate size, which are often even higher for small issues. The company is required, in addition to above, to incur recurring costs for maintenance of share registry cell, stock exchange listing fee, expenditure on printing and posting of annual reports, etc. These items of expenditure can be ill-afforded by the business when it is new. Assistance from venture fund does not require such expenditure. **Business partner:** The venture capitalists act as business partners who share the rewards as well as the risks.

Mentoring: Venture capitalists provide strategic, operational, tactical and financial advice based on past experience with other companies in similar situations.

Alliances: The venture capitalists help in recruitment of key personnel, improving relationship with international markets, coin vestment with other VC firms and in decision making.

III. General

1. A developed venture capital institutional set-up reduces the time-lag between a technological innovation and its commercial exploitation.

2. It helps in developing new processes/products in conducive atmosphere, free from the dead weight of corporate bureaucracy, which helps . in exploiting full potential.

3. Venture capital acts as a cushion to support business borrowings, as bankers and investors will not lend money with inadequate margin of equity capital.

4. Once venture capital funds start earning profits, it will be very easy for them to raise resources from primary capital market in the form of equity and debts. Therefore, the investors would be able to invest in new business through venture funds and, at the same time, they can directly invest in existing business when venture fund disposes its own holding. This mechanism will help to channelise investment in new high-tech business or the existing sick business. These business will take-off with the help of finance from venture funds and this would help in increasing productivity, better capacity utilisation, etc.

5. The economy with well-developed venture capital network induces the entry of large number of technocrats in industry, helps in stablising industries and in creating a new set of trained technocrats to build and manage medium and large industries, resulting in faster industrial development.

6. A venture capital firm serves as an intermediary between investors looking for high returns for their money and entrepreneurs in search of needed capital for their start-ups.

7. It also paves the way for private sector to share the responsibility with public sector.

GUIDELINES

The following are the guidelines issued by the Government of India.

1. The public sector financial institutions, State Bank of India, scheduled banks, foreign banks and their subsidiaries are eligible for setting the venture capital funds with a minimum size of 10 crore and a debt-equity ratio of 1: 1.5. If they desire to raise funds from the public, promoters will be required to contribute a minimum of 40 per cent of capital. Foreign equity up to 25 per cent subject to certain conditions would be permitted.

The guidelines provide for non-resident Indians investment up to 74 per cent on a repatriable basis and 25 per cent to 40 per cent on a non-repatriable basis. It should invest 60 per cent of its funds in venture capital activity. The balance amount can be invested in new issue of any existing or new company in equity, cumulative convertible preference shares, debentures, bonds or any other security approved by Comptroller of Capital Issues.

2. The venture capital companies and venture capital funds can be set up joint venture between stipulated agencies and non—institutional promoters t the equity holding of such promoters should not exceed 20 per cent and should not be largest single holder.

3. Venture capital assistance should go to enterprises with a total vestment of not more than 10 crore.

4. The Venture Capital Company (VCC)/Venture Capital Fund (VCF) should be managed by professionals and should be independent of the parent organization.

5. The VCC/VCF will not be allowed to undertake activities such as trading ,broking, money market operation, bills discounting, interoperate ding. They will be allowed to invest in leasing to the extent of 15 per cent e total funds developed. The investment on revival of risk units will be ated as a part of venture capital activity.

6. Listing of VCCs/VCF can be according to the prescribed norms and underwriting of issues at the promoter's discretion.

7. A person holding a position or full-time chairman/president, chief executive, managing director or executive director/whole time director in a company will not be allowed to hold the same position simultaneously in the VCC/VCF.

8. The Venture Capital assistance should be extended to:

(i) The enterprise having investment up to Z 10 crore in the project.

(ii) The technology involved should be new and untried or it should incorporate significant improvement over the existing technologies in India.

(iii) The promoters should be new, professionally or technically qualified with inadequate resources.

(iv) The enterprise should be established in the company form employing professionally qualified person for maintenance of accounts.

9. Share pricing at the time of disinvestment by a public issue or general sale offer by the company or fund may be done subject to this being calculated an objective criteria and the basis disclosed adequately to the public.

THE INDIAN SCENARIO

Methods of venture financing

Venture capital is available in four forms in India:

1. Equity participation.

2. Conventional loan.

3. Conditional loan.

4. Income notes.

1. Equity participation: Venture capital firms participate in equity through direct purchase of shares but their stake does not exceed 49 per cent. These shares are retained by them till the assisted-Projects Ilia-king profit. These shares are sold either to the promoter at negotiated price under buyback agreement or to the public in the secondary market at a profit.

2. Conventional loan: Under this form of assistance, a lower fixed rate of interest is charged till the assisted units become commercially operational, after which the loan carries normal or higher rate of interest. The loan has to be repaid according to a predetermined schedule of repayment as per terms of loan agreement.

3. Conditional loan: Under this form of finance, an interest free loan is provided during the implementation period but it has to pay royalty on sales The loan has to be repaid according to a predetermined schedule - as soon is the company is able to generate sales and income.

4. Income notes: It is a combination of conventional and conditional loans. Both interest and royalty are payable at much lower rates than in case: of conditional loans.

At present, several venture capital firms are incorporated in India and they are promoted either by All India Financial Institutions like IDBI, ICI ,IFCI, State level financial institutions, public sector banks or promoted by foreign banks/private sector or financial institutions like Indus Venture Capital Fund. The present venture capital players can be broadly classified into the following four categories:

LEASING

Traditionally, firms acquire productive assets and use them as owners. The sources of finance to a firm for procuring assets may be internal or external. Over the years, there has been a declining trend in the internally generated resources of Indian companies due to low profitability. The financial institutions experience paucity of funds at their disposal to meet the increasing needs of borrowers. Further, modern business environment is becoming more and more complex. To succeed in the situation, the firms aim at growth with stability. To accomplish this objective, firms are required to go for massive expansion, diversification and modernization. Essentially, such projects involve a huge amount of investment. High rate of inflation, severe cost escalation, heavy taxation and meagre internal resources forced many companies to look for alternative means of financing the projects. Leasing has emerged as a new source of financing capital assets.

CONCEPT OF LEASING

Leasing, as a financing, concept is an arrangement between two parties, the leasing company or lessor and the user or lessee, whereby the former arranges to buy capital equipment for the use of the latter for an agreed period of time in return for the payment of rent. The rentals are predetermined and payable at fixed intervals of time, according to the mutual convenience of both the parties. However, the lessor remains the owner of the equipment over the primary period.

By resorting to leasing, the lessee company is able to exploit the economic value of the equipment by using it as if he owned it without having to pay for its capital cost. Lease rentals can be, conveniently paid over the lease period out of profits earned from the use of the equipment and the rent is cent per cent tax deductible.

.A Lease is defined as follows:

'Lease is a form of contract space, structure or equipment, in form of a rent'. Transferring the use or occupancy of land, consideration of a payment, usually in the form of a rent.

'Lease is a contract whereby the owner of an asset (lessor) grants to another party (lessee) the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent'.

'A contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee. The lessor retains the ownership of the asset. The lessee has possession and use of the asset on payment of specified retain over the period'.

Thus, in a contract of lease, there are two parties involved: (i) lessor and (ii) the lessee. The lessor can be'a company, a cooperative society, a partnership firm or an individual in manufacturing or allied activities. The lessee can be even a doctor or any other specialists who use costly equipment for the practice of his profession.

Leasing as a source of finance

Leasing is an important source of finance for the lessee. Leasing companies finance for:

1. Modernisation of business.
2. Balancing equipment.
3. Cars, scooters and other vehicles and durables.
4. Items entitled to 100 per cent or 50 per cent depreciation.
5. Assets which are not being financed by banks/institutions.

STEPS INVOLVED IN LEASING TRANSACTION

The steps involved in a leasing transaction are summarized as follows:

1. First, the lessee has to decide the asset required and select the supplier. He has to decide about the design specifications, the price, warranties, terms of delivery, servicing, etc.

2. The lessee, then enters into a lease agreement with the lessor. The lease agreement contains the terms and conditions of the lease such as,

(a) The basic lease period during which the lease is irrecoverable.

(b) The timing and amount of periodical rental payments during the lease period.

(c) Details of any option to renew the lease or to purchase the asset at the end of the period.

(d) Details regarding payment of cost of maintenance and repairs, taxes, insurance and other expenses.

3. After the lease agreement is signed, the lessor contacts the manufacturer and requests him to supply the asset to the lessee. The lessor makes payment to the manufacturer after the asset has been delivered and accepted by the lessee.

CLASSIFICATION OF LEASE

The lease agreement can be classified broadly into four categories: ,

1. Financial lease: A financial lease is also known as capital lease, long-term lease, net lease and close lease. In a financial lease, the lessee selects the equipment, settles the price and terms of sale and arranges with a leasing company to buy it. He enters into a irrevocable and non-cancellable contractual agreement with the leasing company. The lessee uses the equipment exclusively, maintains it, insures and avails of the after-sales service and warranty backing it. He also bears the risk of obsolescence as it stands committed to pay the rental for the entire lease period.

The financial lease could also be with purchase option, where at the end of the predetermined period, the lessee has the option to buy the equipment at a predetermined value or at a nominal value or at fair market price. The financial lease may also contain a non-cancellable clause which means that the lessor transfers the title to the lessee at the end of the lease period.

Under a financial lease, the rate of lease would be fixed based on the d of lease, the period of lease, periodicity of rent payment, and the rate of depreciation and other tax benefits available. The leasing company also charges nominal service charges to cover legal and other costs. The leasing company :may also insist or, collaterals or bank's guarantee in individual cases. In a large number of cases, the financial leases are used as financing-cum-tax planning tool.

The financial lease is very popular in India as in other countries like SA, UK and Japan. On an all India basis, at present, approximately a lease worth Rs 75 crore to Rs100 crore is transacted as a tax planning device. The high cost of equipment such as office equipment, diesel generators, machine tools, textile .machinery, containers, locomotives, etc., are leased under financial lease.

2. Operating lease: An operating lease is also known as service lease, short-term lease or e lease. In this lease, the contractual period between lessor and lessee is s than the full expected economic life of equipment. This means that the ase is for a limited period, may be a month, six months, a year or few years. e lease is terminable by giving stipulated notice as per the agreement. Normally, the lease rentals will be higher as compared to other leases on account of short period of primary lease. The risk of obsolescence is enforced on the lessor who will also bear the cost of maintenance and other relevant expenditure. The lessor also does the services like handling warranty claims, paying taxes, scheduling and performing maintenance and keeping complete records lease suitable for,

(i) Computers, copy machines and other office equipments, vehicles, material handling equipments, etc., which are sensitive to obsolescence and

(ii) Where the lessee is interested in tiding over temporary problem. Distinction between a financial lease and operating lease

Financial Lease	Operating Lease
1. A financial lease is like an installment loan. It is a legal commitment to pay for the entire cost of the equipment plus interest over a specified period of time. The lessee commits to a series of payment which in total exceed the cost of the equipment.	1. An operating lease is a rental agreement. The lessee is not committed to paying more than the original cost of equipment during contractual period.
2. It excludes provisions for maintenance or taxes which are paid separately by the lessee.	2. Operating lease provides for maintenance expenses and taxes of the lessor.
3 The risk of obsolescence is assumed by the lessee.	3. Leasing company assumes risk of obsolescence.
4. Contract period ranges from medium to long-term.	4. Contract period ranges from intermediate to short-term.
5. Contracts are usually non-cancellable.	5. Contracts are usually cancellable either by the lessor or by the lessee.
6. Aircrafts, land and building, heavy machinery are leased.	6. Computers, office equipments, auto-mobiles, truck, etc., are leased.
7. The lease involves a financial commitment similar to a loan by a leasing company. It places the lessee in a position or borrow. 8. The lessor fulfils financial function.	7. The financial commitment is restricted to regular rental payment. The rentals find a place in the P&L A/c of the lessee. 8. The lessor fulfils service function

3.Leverage lease

A leverage lease is used for financing those assets which require huge capital outlay. The outlay for purchase cost of the asset generally varies from Rs.50 lakh to Rs.2 crore and has economic life of 10 years or more. The leverage' lease agreement involves three parties — the lessee, the lessor and the lender. e lessor acquires the assets as per the terms of the lease agreement but finances .only a part of the total investment, say 20 per cent to 50 per cent. The balance is provided by a person or a group of persons in the form of loan to the lessor. The loan is generally secured by mortgage of the asset besides assignment of the leased rental payments. The position of the lessee under a leveraged leasing agreement is the same as in the case of any other type of lease. In leveraged lease, a wide range of equipments such as railroad, rolling stock, coal mining, electricity generating plants, pipelines, ships, etc. are acquired.

Under a leverage lease, there are some attractive investment features in the form of after-tax consequences for the owner of the equipment. By investing 20 per cent or 25 per cent of the cost of an asset, the lessor is entitled to 100 per cent allowance for depreciation plus the investment allowance. In addition, interest expenses related to his borrowings are also tax deductible. From the point of view of lessee, lease rentals are deductible in full as an operating expense.

4. Sale and lease back :Under this type of lease, a firm which has an asset sells it to the leasing company and gets it back on lease. The asset is generally sold at its market value. The firm receives the sale price in cash and gets the right to use the asset during the lease period. The firm makes periodical rental payment to the lessor. The title to the asset vests with the lessor. Most of the lease back agreements are on a net-net basis which means that the lessee pays all maintenance expenses, property taxes and insurance. In some cases, the lease agreement allows the lease to repurchase the property at the termination of lease.

The sale and lease back agreement is beneficial to both lessor and lessee. The lessor gets immediate cash which becomes available for working capital or for further expansion and lessor gets tax benefitRetail stores, office buildings, multipurpose industrial building and shopping centres are financed under this method.

5. Cross-border lease: Cross-border lease is international leasing and is known as transnational leasing. It relates to a lease transaction between a lessor and lessee domiciled in different countries and includes exports leasing. In other words, the lessor may be of one country and the lessee may be of another country. To illustrate, if a leasing company in USA makes available an air bus on lease to air India, there would be a cross-border lease.

Indian leasing industry is unlikely to deal in export border leases for big ticket items such as aircraft but it is well placed to contribute to India's export earnings by offering the lease option. First leasing company hat+ initiated discussions with Buigar Leasing of Bulgaria to export bull Llozern and shovels in significant number of an export lease to that country.

6. Wet lease and dry lease A wet lease is one where the lessor is responsible for full control and maintenance of leased asset. For instance, the Jet Airways has entered into a wet lease agreement with Oman Airways for two air buses for 6 months from May 2009.

On the other hand, a dry lease involves the payment of insurance and maintenance costs by the lessee.

7.Vendor leasing

A vendor leasing is one where the retail vendors tie-up with the lease finance companies which give financing option to the customers of the vendors to purchase a product. This type of lease is popular in auto finance.

INSTALLMENT BUYING, HIRE PURCHASE AND LEASING

In installment buying, the property passes on to the buyer immediately as soon as the first installment is made. The balance amount is payable in installments. Under the contract of installment, the buyer has no right to return the goods. In case of default, the seller has the right to file a suit in the court of law to recover his dues.

Hire purchase is an agreement under which the owner delivers the goods to the buyer who agrees to make periodical payment as hire charges. The possession of goods vests with the hirer but the ownership remains with the seller. On full payment of hire charges, the buyer gets the option of purchasing the goods. On default, the seller can reclaim the goods, subject to certain provisions of Hire Purchase Act.

Hire purchase resembles leasing in certain ways. In both the cases, the right to use the equipment is transferred to the hirer/lessee.

In leasing, the entire lease rentals represents a hire charge and it is treated as expense and hence tax deductible. Under hire purchase, a part of installment represents capital payment and hence it is not an expense. A part of the installment is interest on the loan which is considered as revenue expenditure and hence it is tax deductible.

In leasing, rental charges are debited to Profit and Loss Account and the leased asset is not shown in the Balance Sheet of the lessee. As against this, the hire purchaser capitalizes the asset 'brought under hire purchaser contract. The liability for future hire purchase installments not yet due is shown separately in the balance sheet.

ADVANTAGES OF LEASE

The following are the advantages of leasing:

1. Permit alternative use of funds: A leasing arrangement provides a firm with the use and control over asset without incurring huge capital expenditure. The firm is required only to make periodical rental payments. It saves considerable funds for alternative uses which would otherwise be tied up in fixed capital.

2. Faster and cheaper credit: Depending on tax structure of the lessee, it costs less than other methods of acquiring assets. It permits firms to acquire new equipment without going through formal scrutiny procedure. Hence, acquisition of assets under leasing agreement is cheaper and faster than any other source of finance.

3. Flexibility: Leasing arrangements may be tailored to the lessee's needs more easily tha ordinary financing. Lease rentals can be structured to match the lessee's cash flows. It can be skipped during the months when the cash flows are expected to be low.

4. Facilitates additional borrowings: Leasing may increase long-term ability to acquired funds. The lessee can utilise more funds for working capital needs. Moreover, acquisition of assets under the lease agreement does not alter debt-equity ratio. Hance, the lessee can go for additional borrowings in case need arises.

5. Protection against obsolescence: A firm can avoid risk of obsolescence by entering into operating lease agreement. This is highly useful in respect of assets which become obsolete at a faster rate.

6. No restrictive covenants: The restrictive covenants such as debt- equity ratio, declaration of dividend, etc., which are usually imposed under debenture or loan agreement are absolutely absent in a lease agreement.

7. Hundred percent financing: Lease financing enables a firm to acquire the use of an asset without having to make a down payment. So, hundred per cent financing is assured to the lessee.

8. Boon to small firm: The firms which are either small or have uncertain records of earning are able to obtain the use of asset through lease financing. It is a boon to small firms and technocrats who are able to make promoter's contribution as required by financial institutions.

DISADVANTAGES OF LEASING

1. Lease is not a suitable mode of project finance. This is because rentals are repayable soon after entering into lease agreement while in new projects cash generations may start only after a long gestation period.

2. Certain tax benefits/incentives such as subsidy may not be available on leased equipment.

3. The value of real assets such as land and building may increase during lease period. In such a case, the lessee loses the advantage of a potential capital gain.

4. The cost of financing is generally higher than that of debt financing.

5. A manufacturer who wants to discontinue a particular line of business will be not in a position to terminate the contract except by paying heavy penalties. If it is a owned asset, the manufacturer can sell the equipment at his will.

6. If the lessee is not able to pay rentals regularly, the lessor would suffer a loss particularly when the asset is a sophisticated one and less liquid.

7. In case of lease agreement, it is lessor who has purchased the asset from the supplier and not the lessee. Hence, the lessee by himself is not entitled to any protection in case the supplier commits breach of warranties in respect of the leased assets.

8. In the absence of exclusive laws dealing with the lease transaction, several problems crop up between lessor and lessee resulting in unnecessary complications and avoidable tension.

HISTORY AND DEVELOPMENT OF LEASING (EVOLUTION)

The history of leasing dates back to 200 B.0 when Sumerians leased goods. Romans had developed a full body law relating to lease for movable and immovable property. However, the modern concept of leasing appeared for the first time in 1877 when the Bell Telephone Company began renting telephones in the USA. In 1832, Cottrell and Leonard leased academic caps, gowns and hoods. Subsequently, during 1930s, the Railway Industry used leasing service for its rolling stock needs. In the post-war period, the American Airlines leased their jet engines for most of the new aircrafts. This development ignited immediate popularity for the lease and generated growth of leasing industry.

Since World War II, the use of leasing has been greatly expanded and is constantly used for new products and new industries. In May 1952, Henry Scholfeld set up a separate Corporation in the USA to handle lease transaction. He founded the US Leasing Corporation with a capital of $ 20,000. Since 1963, commercial banks have been allowed to engage themselves in direct leasing. In the early 1960s, leasing entered the United Kingdom following its successful and rapid development in the USA.

The concept of financial leasing was pioneered in India during 1973. The first company was set up by the Chidambaram Group in 1973 in Madras. The company undertook leasing of industrial equipment as its main activity. The Twentieth Century Leasing Company Limited was established in 1979. By 1981, four finance companies joined the fray. The performance of First Leasing Company Limited and the Twentieth Century Leasing Company Limited motivated others to enter the leasing industry. In 1980s, financial institutions made entry into leasing business. Industrial Credit and Investment Corporation was the first of all India financial institution to offer leasing in 1983. Entry of commercial banks into leasing was facilitated by an amendment of Banking Regulation Act, 1949. State Bank of India was the first commercial bank to set up a leasing subsidiary, SBI capital market, in October 1986. Canbank Financial Services Ltd., BOB Financial Service Ltd., and PNB Financial Services Limited followed suit. Industrial Finance Corporation's Merchant Banking division started financing leasing companies as well as equipment leasing and financial services. There was thus virtual explosion in the number of leasing companies rising to about 400 companies in 1990.

In the subsequent years, the adverse trends in capital market and other factors led to a situation where apart from the institutional lessors, there were hardly 20 to 25 private leasing companies who were active in the field. The total volume of leasing business transacted by both private and public sector leasing companies was Rs.5,000 crore in 1993 and it is expected to cross Rs.10,000 crore by March 1995.

LEGAL ASPECTS OF LEASING

As there is no separate statute for equipment leasing in India, the provisions relating to bailment in the Indian Contract Act govern equipment leasing agreements as well. Section 148 of the Indian Contract Act defines bailment as:

The delivery of goods by one person to another, for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the 'bailor' and the person to whom they are delivered is called the 'bailee'.

Since an equipment lease transaction is regarded as a contract of bailment, the obligations of the lessor and the lessee are similar to those of the bailor and the bailee (other than those expressly specified in the lease contract) as defined by the provisions of Sections 150 and 168 of the Indian Contract Act. Essentially, these provisions have the following implications for the lessor and the lessee.

1. The lessor has the duty to deliver the asset to the lessee, to legally authorize the lessee to use the asset, and to leave the asset in peaceful possession of the lessee during the currency of the agreement.

2. The lessee has the obligation to pay the lease rentals as specified in the lease agreement, to protect the lessor's title, to take reasonable care of the asset, and to return the leased asset on the expiry of the lease period.

CONTENTS OF A LEASE AGREEMENT

The lease agreement specifies the legal rights and obligations of the lessor and the lessee. It typically contains terms relating to the following:

1. Description of the lessor, the lessee, and the equipment.
2. Amount, time, and place of lease rental payments.
3. Time and place of equipment delivery.
4. Lessee's responsibility for taking delivery and possession of the leased equipment.
5. Lessee's responsibility for maintenance, repairs, registration, etc, and the lessor's right in case of default by the lessee.
6. Lessee's right to enjoy the benefits of the warranties provided by the equipment manufacturer/supplier.
7. Insurance to be taken by the lessee on behalf of the lessor.
8. Variation in lease rentals if there is a change in certain external factors like bank interest rates, depreciation rates, and fiscal incentives.
9. Option of lease renewal for the lessee.
10. Return of equipment on expiry of the lease period.
11. Arbitration procedure in the event of dispute.

Hire Purchase

Hire purchase is a method of selling goods. In a hire purchase transaction, the goods are let out on hire by a finance company (creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes on to hire on the payment of last installment.

FEATURES OF HIRE PURCHASE AGREEMENT

1. Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.

2. Each installment is treated as hire charges.

3. The ownership of the goods passes from buyer to seller on the payment of the installment.

4. In case the buyer makes any default in the payment of any installment, the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charge.

5. The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the sums already paid as such sums legally represent hire charge on the goods in question.

LEGAL POSITION

The Hire Purchase Act, 1972 defines a hire purchase agreement as, an agreement under which goods are let on hire and under which the hirer has arroption to purchase them in accordance with the terms of agreement under which:

1. Payment is to be made in installments over a specified period.

2. The possession is delivered to the purchaser at the time of entering into a contract.

3. The property in the goods passes to the purchaser on payment of the last installment.

4. Each installment is treated as hire charge so that if default is made in payment of any one installment, the seller is entitled to take away the goods.

5. The hirer/purchaser is free to return the goods without being required to pay any further installments falling due after the return.

HIRE PURCHASE AGREEMENT

There is no prescribed form for a hire purchase agreement, but it has to be in writing and signed by both parties to the agreement.

A hire purchase agreement must contain the following particulars:

(i) The description of goods in a manner sufficient to identify them.
(ii) The hire purchase price of the goods.
(iii) The date of commencement of the agreement.
(iv) The number of instalments in which hire purchase price is to be paid, the amount, and due date.

HIRE PURCHASE AND CREDIT SALE

Higher purchase transaction is different from credit sale. In case of actual sale, the title in the property, i.e., ownership and possession is transferred to the purchase simultaneously, in hire purchase, the ownership remains with the seller until last installment is paid.

HIRE PURCHASE AND INSTALLMENT SALE

Hire purchase transaction is different from installment system. In case of installment system, it is not only the possession but also the ownership of goods which is transferred to the buyer immediately at the time of agreement. Further, when 14-e buyer stops payment of dues, the seller has no right to repossess " ds. He has the only right to sue the buyer for the non-. pav- rigthe goods but has the right of disposing of the good likes. Any loss of goods should be borne only by th the ownership.

oflLEASING • —6 different from leasing. tract of lease; the ownership rests with the le 'rer) has no option to purchase the goods.

(ii) Method of financing: Leasing is a method of financing business assets whereas hire purchase is a method of financing both business assets and consumer articles.

(iii) Depredation: In leasing, depreciation and investment allowance cannot be claimed by the lessee. In hire purchase, depreciation and investment allowance can be claimed by the hirer.

(iv) Tax benefits: The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

(v) Salvage value: The lessee, not being the owner of the asset, does not enjoy the salvage value of the asset. The hirer, in purchase, being the owner of the asset, enjoys salvage value of the asset.

(vi) Deposit: Lessee is not required to make any deposit, whereas 20 per cent deposit is required in hire purchase.

(vii) Rent-purchase: With lease, we rent and with hire purchase we buy the goods.

(viii) Extent of finance: Lease financing is invariably 100 per cent financing. It requires no immediate down payment or margin money by the lessee. In hire purchase, a margin equal to 20-25 per cent of the cost of the asset is to be paid by the hirer.

(ix) Maintenance: The cost of maintenance of the hired asset is to be borne by the hirer himself. In case of finance lease only, the maintenance of leased asset is the responsibility of the lessee.

(x) Reporting: The asset on hire purchase is shown in the balance sheet of the hirer..The leased assets are shown by way of footnote only.

Differences between Hire Purchase and Leasing

Criteria	Hire Purchase	Leasing
Ownership	Financier	Lessor
Relationship	Owner- hirer	Lessor- lessee
Buying	Owner purchases and supplies to the hirer	Lessor purchases and supplies to Lessee
Compensation	Hire charges	Lease rent
Repayment	Hire charges paid along with installments	Lease rent paid periodically
Insurance	At owner's cost	At lessor's cost

ORIGIN AND DEVELOPMENT (EVOLUTION)

The growth and development of hire purchase system can be traced luck to the advent of industrial development in UK. Henry Moore, a Bishogate piano-maker introduced the system of hire purchase in 1846 in UK. Cowperwait & Sons, a furniture dealer introduced the hire purchase system in the US in 1807. The singer manufacturing company started selling sewing machine under hire purchase agreement. The idea was developed by Wagon Companies which were formed to finance the purchase of wagons by collieries. The Wagon 'companies bought the wagons and then let them out collieries under hire purchase agreement.

All early hire purchase transactions were financed by manufacturers or dealers themselves. Subsequently, independent finance house came into existence to offer hire purchase of wide variety of consumer articles, automobiles and industrial machinery on hire purchase.

In India, hire purchase finance started only after World War I. However, it was only after World War II that its growth assumed visible dimension. The concept of hire purchase was not quite popular in the pre-independence period though a few were endeavouring to increase the volume of their business with the provision of extending credit to intending buyers. With the increase in economic activity, many non-banking financing companies entered the scene in the fifties and sixties.

The pioneer in the field were Commercial Credit Corporation Limited, Motor and General Finance Limited and Investments Supply Limited. These companies were set-up predominantly to finance road transport sector. The volume of hire purchase business was around 635 crore in 1987-88, out of which automobiles accounted for 55 per cent. Today, about 25 per cent of sale of commercial vehicles is accounted by hire purchase. It is estimated by the Federation Hire Purchase Association that the stock-on-hire of hire purchase companies comprising corporate and non-corporate entities would be approximately Rs3,000 crore now.

In addition to commercial vehicles, purchase of consumer articles like household appliances, air-conditioners, refrigerators, office furniture and equipment are financed through hire purchase. In recent years, the consumer durable goods market is experiencing an unprecedented boom. The growing Indian middle class — 100 to 150 million, growing at a rate of 20 per cent per annum and their willingness to mortgage the future for today's enjoym2nt have led to spectacular growth in hire purchase business.

The institutions engaged in the hire purchase business in organized sector Ins tide commercial banks, cooperatives banks, State Finance Corporations, Na (tonal Small Industries Corporations and in the unorganized sector they comprise a large number of partnership firms and individuals.

The National Small Industries Corporation supplies machineries to small-scale industries under hire purchase. The Industrial Development Bank of India indirectly participates in financing hire purchase business by way of rediscounting usance bills/promotes arising out of sale of indigenous machinery on hire purchase basis. The Industrial Credit and Investment Corporation also has a discounting scheme of usance bills under hire purchase scheme.
